DISABUSING THE TAX AID NARRATIVE: WHAT INTER-NATIONAL TAX EQUITY *REALLY* MEANS FOR "POOR" COUNTRIES AND HOW TO (RE)FRAME IT

by

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DEDICATION

To all the brave people helping humanity overcome a global pandemic. To a century of international tax history.

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ABSTRACT

International tax regimes (e.g., the "double taxation regime") are created by states with competing tax jurisdiction to coordinate their tax rules and, specifically, to address common efficiency problems like international double taxation. In developing such regimes, states attempt to balance competing tax policy priorities: efficiency, administrability, and equity. This work engages with equity, as a policy norm of international tax (inter-national tax equity). It is my thesis that the framing/articulation of inter-national tax equity suffers from a narrative problem that, perhaps, stems from its apparent conceptual unclarity and multifarious usage. This narrative problem is most evident in the articulation of inter-national tax equity with regard to the taxing rights claims of low-income/developing countries (LIDCs), where there is a tendency to conflate equity with tax aid. I illuminate the potential implications of the narrative problem and then – drawing on subsisting theories of tax jurisdiction, international relations, and reasonableness, respectively – propound the concept of "reasonable impairment compromise" (RIC) as a suitable normative/evaluative framework for inter-national tax equity. RIC claims that: (1) a state's right to tax is an inherent attribute of its sovereignty; (2) international tax regimes are not strictly technical regimes but are, instead, products of political compromise that overlay/impair the exercise of inherent tax jurisdiction; and (3) the question of whether a particular regime/compromise is equitable (fair) is *really* a question of reasonableness. Therefore, to measure the fairness of a given compromise/regime, it is apposite to focus on the degree (severity) of impairment. Only a compromise that impairs the exercise of tax jurisdiction to a "reasonable" extent can be deemed equitable. To determine reasonableness, we must weigh the practical implications of the compromise for individual states (or class of states), considering a totality of objective factors. The thesis develops a 5-factor reasonableness test, which I then use to evaluate the fairness of various components of the double taxation regime, as well as the emerging multilateral regime for taxation of the digital economy. For LIDCs, "reasonable" (equitable) would typically – but not always – describe a compromise that does not severely restrict a state's scope for domestic revenue mobilization.

ABBREVIATIONS

ADS – Automated Digital Service(s)

ALP – Arm's Length Principle (or Standard)

ATAF – African Tax Administration Forum

AU – African Union

B2B – Business-to-Business

B2C – Business-to-Customer

BEPS – Base Erosion and Profit Shifting

BIAC – Business at the OECD

CbCR – Country-by-Country Reporting

CFB – Consumer Facing Business

CITA – Companies Income Tax Act

CSO – Civil Society Organizations

DRM – Domestic Revenue Mobilization

DTT/C – Double Tax Treaty/Convention

EC – European Commission

EU – European Union

FFD – (International) Financing for Development

G7 – Group of 7 Countries

G20 – Group of 20 Countries

G24 – Intergovernmental Group of 24

G77 – Group of 77 at the United Nations

GDP – Gross Domestic Product

GNI – Gross National Income

HIDC – High-Income/Developed Country

HMRC – Her Majesty's Revenue and Customs

IBRD – International Bank for Reconstruction and Development

ICC – International Chamber of Commerce

ICTD – International Centre for Taxation and Development

IFC – International Finance Corporation

IMF – International Monetary Fund

ITA – Income Tax Act

LAFTA – Latin American Free Trade Association

LIDC – Low-Income/Developing Country

MLI – Multilateral Instrument

MNC/MNE – Multinational Corporation/Enterprise

LFN – Laws of the Federation of Nigeria

OECD – Organization for Economic Cooperation and Development

OECD MTC – OECD Model Convention on Taxation of Income and of Capital

OEEC – Organization for European Economic Co-operation

PE – Permanent Establishment

POEM – Place of Effective Management

RIC – Reasonable Impairment Compromise

SEP – Significant Economic Presence

TNC – Transnational Corporation

TP – Transfer Pricing

TRIPS – Agreement on Trade Related Aspects of Intellectual Property

UK – United Kingdom

UN – United Nations

UNCTAD – United Nations Conference on Trade and Development

UNMTC – United Nations Model Double Taxation Convention between Developed and Developing Countries

UNECA – United Nations Economic Commission for Africa

US – United States

USTR – United States Trade Representative

WATAF – West African Tax Administration Forum

WTO – World Trade Organization

WW1 – World War One or First world War

WW2 – World War Two or Second world War

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Chapter 1: Introduction: The Case for Inter-national Tax Equity

> *One day two women came to King Solomon, and one of them said: Your Majesty, this woman and I live in the same house. Not long ago my baby was born at home, and three days later her baby was born. Nobody else was there with us. One night while we were all asleep, she rolled over on her baby, and he died. Then while I was still asleep, she got up and took my son out of my bed. She put him in her bed, then she put her dead baby next to me. In the morning when I got up to feed my son, I saw that he was dead. But when I looked at him in the light, I knew he wasn't my son. "No!" the other woman shouted. "He was your son. My baby is alive!" "The dead baby is yours," the first woman yelled. "Mine is alive!" They argued back and forth in front of Solomon, until finally he said, "Both of you say this live baby is yours. Someone bring me a sword." A sword was brought, and Solomon ordered, "Cut the baby in half! That way each of you can have part of him." "Please don't kill my son," the baby's mother screamed. "Your Majesty, I love him very much, but give him to her. Just don't kill him." The other woman shouted, "Go ahead and cut him in half. Then neither of us will have the baby." Solomon said, "Don't kill the baby." Then he pointed to the first woman, "She is his real mother. Give the baby to her." Everyone in Israel was amazed when they heard how Solomon had made his decision. They realized that God had given him wisdom to judge fairly*.[1]

1.1 Background, Research Questions and Thesis Roadmap

The international tax regime[2] is an enormous regulatory orbit that largely consists of "compromises" agreed or adopted by sovereign states to govern or coordinate how they exercise

[1] The Holy Bible (Contemporary English Version), 1 Kings 3:16-28.

[2] The phrase "international tax regime" is a common feature of international tax scholarship and it is often used alternatively with "international tax system". See, for instance, Richard M Bird, "Are Global Taxes Feasible?" (2018) 25 Int'l Tax Pub Fin 1372; Ana Paula Dorado, "The OECD Unified Approach and the New International Tax System: A Half-Way Solution" (2020) 48:1 Intertax 3. Also, Reuven S Avi-Yonah, *International Tax as international Law: An Analysis of the International Tax Regime* (Cambridge: Cambridge University Press, 2007) at 1 ["This book has a thesis: that a coherent international tax regime exists, embodied in both the tax treaty network and in domestic laws, and that it forms a significant part of international law (both treaty-based and customary). The practical implication is that countries are not free to adopt any international tax rules they please, but rather operate in the context of the regime, which changes in the same ways international law changes over time"]. Avi-Yonah (at 8–130) further contends that the "international tax regime comprises" two elements: the single tax principle and the benefits principle. The single tax principle suggests that income should be tax once, and just once (either at residence or source), while the benefits principle suggests that passive income should be taxed in the country of residence while active income should be taxed in the country of source. In terms of terminology, Diane Ring takes a more pluralistic view of international tax governance. She opines that there is not one "international tax regime", but rather various regimes, one of which is the double taxation regime. See Diane Ring, "International Tax Relations: Theory and Implications" (2007) 60:2 Tax L Rev 83. It is also common for scholars to state "international tax order", with the concept of a system or regime seemingly implicit. See, for instance, Allison Christians, "What's Up: BEPS and the New International Tax Order" (2016) 2016:6 BYU L Rev 1603; Adam S Michel, "The Treasury Should Disengage from the OECD Digital Tax Process" (Grover, Hermann Centre for Federal Budget Backgrounder No. 3445, 2019). My preference for the term

their respective rights to tax international economic activities that penetrate their sovereign borders.[3] The recently concretizing OECD BEPS Pillar One tax deal (discussed in chapter 3) is such a compromise – a monumental one – fashioned through a multilateral framework to address tax issues arising from the digitalization of the global economy and to apportion (by imposing limits on) taxing rights between states that are entitled to tax. As with domestic tax regimes, countries are mainly concerned with three core policy factors when fashioning the international tax regime (or any component of it): efficiency (neutrality), administrability, and equity.[4] The scholarship on these three key tax policy objectives is vast. However, this thesis focuses on the third policy objective: equity,[5] and only references efficiency and administrability as they become relevant.[6] The thesis deals with the fundamental and protracted question: "how can countries

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"regime" over "system" is mainly informed by acknowledgment of a political overlay over the rules that govern international tax.

[3] I use the term "compromise" in two senses. As a noun, the term refers to an international tax deal or arrangement that limits, restricts, fetters, or impairs the exercise of tax jurisdiction. To compromise – the verb form – is to enter into or adopt an international tax deal or arrangement that limits, etc., tax jurisdiction. Tax compromises take the form of tax treaty stipulations, domestic tax rules or some agreed/adopted framework or "norm" earmarking limits or thresholds for the exercise of taxing rights over income arising from cross-border activities.

[4] These objectives collide. The pursuit of one objective may undermine the effective pursuit of another, which is why trade-offs are inevitable. See Ring *supra* note 2. [pinpoint?] Whatever trade-offs are made impact how much tax revenue countries can derive from cross-border factor movement.

[5] Basically, equity means that people should be treated fairly. In a domestic context, inter-individual equity implies that each person should bear a fair share of the tax burden. One aspect of this theory – benefits theory – holds that people should be taxed in relation to the benefits that they receive from society. Another side of the equity coin – ability-to-pay theory – holds that people should pay taxes in relation to their respective capacities or means. Ability-to-pay theory further comprises horizontal and vertical equity. Horizontal equity mandates that taxpayers with similar earnings should bear similar tax burdens. On the other hand, vertical equity mandates that taxpayers who earn higher or are better off should bear a higher tax burden. For a detailed discussion of equity in tax policy see Tim Edgar & Daniel Sandler, *Materials on Canadian Income Tax* (Toronto: Thomson Canada Ltd, 2005) at 66; David Elkin, "Horizontal Equity as a Principle of Tax Theory" (2006) 24:1 Yale L & Policy Rev 43; Brian Galle, "Tax Fairness" (2008) 65:4 Wash & Lee L Rev 1323; Allison Christians, "Introduction to Tax Policy Theory", *SSRN* (2018), online: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3186791. For examination of the relevance of ability-to-pay theory to international tax, particularly residence-based taxation, see Klaus Vogel, "Worldwide vs. Source Taxation of Income - A Review and Re-evaluation of Arguments (Part III)" (1988) 11 Intertax 393 and Nancy H Kaufman, "Fairness and the Taxation of International Income," (1997) 29:2 L & Pol Intl Bus 152 at 172–182 [both offering reasons why inter-individual equity does not necessarily justify a residence countries' taxation of worldwide income].

[6] Administrability means that countries should be able to enforce the tax systems that they create. It is pointless to enact a tax law that defies enforcement. See Christians *ibid* at 23. Neutrality, on the other hand, means that the tax system should not distort choices and behaviour in otherwise efficient markets. See Loraine Eden, "Equity and Neutrality in the International Taxation of Capital" (1988) 26:2 Osgoode Hall LJ 367 at 370. In other words, taxpayers in similar situations and carrying out similar activities should be subject to similar patterns of tax treatment. This would "neutralize" the incentive to change their behavior to minimize their potential tax liabilities. According to Chen,

equitably – or fairly – allocate the common tax base between them"? More centrally, what does "inter-nation equity" mean for the category of countries that are often labelled "low-income", "developing", or "(net) capital importing" countries?[7]

Again, as I articulate in the contemporaneous footnotes, the discussion on inter-national tax equity is not new. There is a substantial collection of literature on the subject.[8] So, why does it make

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the neutrality of a tax system can be tested by comparing it with a situation where there is no tax. Shu-Chien Jennifer Chen, "Neutrality as Tax Justice: The Case of Common Consolidated Corporate Tax Base under the EU law" (2018) 5 European Studies 33 at 36. A non-neutral tax system creates incentives to reduce tax payments by changing behavior. Economists generally agree that tax policy should raise revenues without unduly distorting the decisions of firms. This is how to ensure the efficient deployment of resources for productivity. See Alex Easson & Eric M Zolt, *Tax Incentives* (Washington DC: World bank, 2002); Richard M Bird & Scott Wilkie, "Designing Tax Policy: Constraints and Objectives in Open Economy" (2012) Georgia State University Int'l Center for Public Policy Working Paper 12-24. In international tax, there are two principal forms of neutrality: capital export neutrality (CEN) and capital import neutrality (CIN). CEN embodies the idea that taxes should not influence investment decisions; and the way to ensure this is to subject capital to the same tax burden whether it is invested at home or overseas. See Ruth Mason & Michael S Knoll, "What is Tax Discrimination?" (2012) 121 Yale LJ 1014 at 1043 (2012). CIN reflects the idea that all capital invested in a particular jurisdiction should be subjected to the same tax burden, regardless of their origin. See David Elkins, "A Critical Reassessment of the Role of Neutrality in International Taxation" (2019) 40:1 Northwestern J Int'l L & Bus 1. Knoll observes that "[t]he central idea in the literature is that an income tax cannot simultaneously satisfy both CEN and CIN unless tax rates on capital are harmonized across countries". See Michael Knoll, "Reconsidering International Tax Neutrality" (2011) 64:2 Tax L Rev 99.

[7] Similar appellations include "poor", "Global South", "least developed", "less developed", "lower-income", "low-to middle-income", etc. The United Nations (UN) classifies countries into three categories, based on metrics of development: developed economies, economies in transition, and developing economies. See UN, "World Economic Situation and Prospects" (2020) online: https://perma.cc/U5GF-N6LX; The UN previously adopted a four-tier classification of countries, based the level of income: low-income, lower middle income, middle income and high-income". See UN, "World Economic Situation and Prospects" (2014) online: https://perma.cc/B8FD-YD2S. I have settled here for the phrase "low-income developing countries" (LIDCs) as a sort of operative umbrella term. I also adopt the phrase "high-income developed countries" (HIDCs) as a parallel phrase for non-LIDC countries.

[8] At least since the seminal works of Richard and Peggy Musgrave, equity considerations have been a mainstay of international tax and tax scholars have broadly drawn on the concept of "inter-nation equity" to address issues of fairness in bilateral or multilateral tax dealings (of many kinds). See Richard A Musgrave & Peggy B Musgrave, "Inter-nation Equity", in R Bird and J Head, eds, *Modern Fiscal Issues: Essays in Honor of Carl S. Shou*p (University of Toronto Press 1972) 68. For uses of inter-nation equity in international tax discourse, see Vogel *supra* note 5 [disputing the appropriateness – on equity and efficiency grounds – of residence-based worldwide taxation]; Joel P Trachtman, "International Regulatory Competition, Externalization, and Jurisdiction" (1993) 34 Harv Intl LJ 47. [examining the regulation of tax competition]; OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1—2015 Final Report* (Paris: OECD, 2015) [for the allocation of taxing rights to the country where economic activities occur and where value is created]; Justus Eisenbeiss, "BEPS Action 7: Evaluation of the Agency Permanent Establishment," (2016) 44 Intertax 481 and Sven Hentschel, *The Taxation of Permanent Establishments A Critical Analysis of the Authorised OECD Approach and Its Implementation in German Tax Law under Specific Consideration of the Challenges Imposed to the PE Concept by the Digitalisation of the Economy* (Wiesbaden: Springer, 2021) at 381 [supporting the expansion of the existing concept of permanent establishment to include sales jurisdictions]; Duncan Bentley, "Taxpayer Rights and Protections in a Digital Global Environment", in RF van Brederode, ed, *Ethics and Taxation* (Singapore: Springer, 2020) 251 [buttressing a jurisdiction's responsibility to protect the rights of its taxpayers in a global digital environment]; Alexander Ezenagu, "Unitary Taxation of Multinational Enterprises for a Just Allocation of Income: Nigeria as a Case Study of Africa's Largest Economies" (McGill University Doctoral

sense to do an entire thesis on a subject that, admittedly, has been vastly explored? There are three (interconnected) reasons. The first has to do with timing. As we live in a world of expanding tax compromises that eat ever so deeply into the sovereignty of individual states, I find that there is need to map out an operational test or yardstick for evaluating whether an international tax compromise conforms with standards of equity or fairness from the perspective of low-income developing countries (LIDCs). The current state of international tax literature does not (sufficiently) fulfill this need, primarily because of the tendencies identified in my second reason. As Burgers & Mosquera duly observe, while there is extensive reference to fairness in discussions of tax systems, that reference is bereft of proper definition of fairness and how fairness can be achieved.[9]

Second, the relevance of this contribution is underscored by what I identify as a narrative problem in the international tax literature with regard to equity issues for LIDCs, especially the literature

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Thesis, 2019) [arguing that a shift to a global unitary tax system based on profit allocation by formulary apportionment approach will achieve fairer distribution of taxing rights]; Irene JJ Burgers, "Value Creation and Inter-Nation Equity" in W Haslehner & M Lamensch, eds, *Taxation and Value Creation,* EATLP Tax Series vol 9 (Amsterdam: IBFD, 2021) [exploring whether the "value creation" method of profit attribution would result in a fairer distribution of taxing rights, in the context of the OECD-led international tax reform efforts]; and Ariel Hakim P Lubis & Ning Rahayu, "Emphasizing Inter-Nation Equity in the New Digital Economy's Taxing Rights Allocation Scheme" (2021) Int'l J Sc and Res Pub 402 [examining the prospects of fairness in the evolving OECD/G20 Pillar One tax deal]. This very fluid use of the concept has led some scholars to ponder on the precise meaning of "inter-nation equity" or the scope of its application. See Kim Brooks, "Internation Equity: The Development of an Important but Underappreciated International Tax Value" in J G Head & R Krever, eds, *Tax Reform in the 21st Century: A Volume in Memory of Richard Musgrave* (The Netherlands: Kluwer Law International, 2009) 471 at 473 ["Given that this 1972 essay forms the starting place for the analysis that follows; has been frequently misunderstood and inadequately developed by subsequent scholars; and constitutes the first major contribution to our understanding of inter nation equity, a relatively detailed discussion of the argument made in the piece seems appropriate]; Ivan Ozai, "Inter-nation Equity Revisited" (2020) 12:58 Columbia J Tax L 58 at 59 & 61 ["Inter-nation equity has become a vague enough term that it is used to justify virtually any possible stance on how to distribute the international tax base while giving the impression that such a stance, because it is purportedly aligned with the concept of inter-nation equity, is grounded in some sense of fairness between nations"…"The concept of inter-nation equity is now ubiquitous in the tax literature. Commentators have applied the concept to a wide array of subjects, frequently beyond the scenarios envisaged by the Musgraves themselves"].

[9] Irene JJ Burgers & Irma J Mosquera Valderrama, "Fairness: A Dire International Tax Standard with No Meaning?" (2017) 45:12 Intertax 767. Compared to the broad and ambitious exploration of "fairness" that is contained in that paper, my thesis undertakes a narrow exploration of "fairness" themed around LIDCs and the question of international taxing rights allocation.

on taxation and development. The narrative that I consider to be troubling, often implicitly, misjudges (or muddles) inter-nation equity as charitable redistribution of tax revenue, a form of "tax aid", from high-income developed countries (HIDCs) to LIDCs. There is need to draw attention to this narrative because to do so can awaken scholarly consciousness about its potential implications.

I am convinced that now is a "next best time" to disabuse the troubling charity narrative that pervades some of the conversation on the taxing rights claims of LIDCs and to explore the potential for a heuristic framework that more suitably streamlines scholarly conversation on international taxation and LIDCs, considering that countries are in the intense process of concretizing a multilateral compromise that could define the international tax regime for generations.[10]

Even as I seek to address the identified narrative problem and to muster a better framing of the subject, I must point out early that it is not my intention to conduct an in-depth conceptual re-examination of inter-nation equity or to comprehensively address the fog around its scope of application. The afore-referenced pieces by Brooks and Ozai are important reference points for that purpose.[11] I have opted, instead, to zero in on inter-nation equity as it concerns the allocation of taxing rights where LIDCs are involved. The Musgraves address this issue, but, perhaps, not in a way that pre-empts the narrative that has organically ensued about the interest of LIDCs in the international tax regime.[12]

I must also acknowledge that this contribution does not make specific proposals for the equitable allocation of taxing rights in any specific case. Rather, I outline a general framework that may be

[10] A better time would have been earlier in the life of the OECD BEPS project when countries were in the initial stages of figuring out what the place of developing countries was.
[11] Brooks, "Inter-nation Equity" *supra* note 8; Ozai (2020) *supra* note 8.
[12] Musgrave & Musgraves *supra* note 8.

used to evaluate whether a compromise can be considered fair to the countries (LIDCs) who, invariably, must "give up" taxing rights to make the intended regime work. I am, therefore, guided throughout this exploration by the pivotal question: is this a fair (reasonable) surrender (compromise) of tax jurisdiction for a country of limited means.?[13]

I should also iterate early that the allocation of taxing rights between countries is an inherently complex matter.[14] Any bilateral or multilateral framework (body of norms) that countries adopt for the purpose is a hybrid of both economic and political influences, even as unilateral cross-border tax policies can also be both economically and politically consequential. It is this complex intersection between the economic and political elements of international taxing rights allocation that evokes pertinent equity concerns. How should countries be guided, from an equity perspective, when making tax deals? What do considerations like "income inequality", "redistribution", "global distributive justice", and "sustainable development" have to do with it?

The view espoused in this work is that all taxing rights allocation claims must be founded, first, on entitlement. Equity (as distinct from aid or charity) is relevant to moderate the extent to which countries *can be expected* to compromise or concede those taxing rights when making tax deals. Therefore, in my view, an ideal conversation on inter-nation equity should proceed from a theoretical analysis of how countries "acquire" taxing rights; proceed to examine how they give

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[13] I am hopeful – optimistic – that the gamut of inter-nation equity, as used here, becomes patent as I traverse this thesis to deal with the identified narrative problem.

[14] See Eden *supra* note 6 at 367–368 ["the international taxation of capital is a complicated subject. It affects the international allocation of capital, the distribution of gains from foreign investment between home and host countries, the returns to residents and non-residents in the host country, and the relative treatment of residents in the home country with domestic income and those with foreign-source income. In 1963, the OECD Fiscal Committee adopted a Model Tax Treaty Convention on Income and Capital to clarify "good behaviour" in this area. The Convention assigns the source or host country the primary right to tax business income earned within its borders. Where multinational enterprises (MNEs) are involved, the tax base is allocated internationally according to the concept of a permanent establishment. The various MNE affiliates are treated as separate legal entities and income is apportioned between them assuming intra-firm transactions to take place at arm's-length prices. The Convention assigns the residence or home country the right to tax remitted income, with the host country having the prior right to levy a withholding tax, and recommends that the home country grant a foreign tax credit."].

up or compromise those taxing rights, and then form an opinion on whether a particular compromise is “fair”, “reasonable”, “just”, or “equitable” to the countries involved, considering their peculiar circumstances. That evaluative framework is what I term “reasonable impairment compromise”. Approaching the equity discourse this way – with clear emphasis on the inherence of taxing rights – provides better clarity on the normative foundations of the taxing rights claims advanced by or on behalf of LIDCs, as opposed to the situation where such claims are framed as appeals for handouts from HIDCs. The principal question that this thesis addresses, therefore, is:

1. What does inter-national tax equity *really* mean for low-income/developing countries (LIDCs and how should we (re)frame it?

The core objective of this work is to improve tax policy in the sphere of international tax. The work attempts to do so by presenting a set of guiding principles for evaluating whether tax deals fairly restrict or impair the tax jurisdiction of sovereign states, particularly states in the LIDC category, who tend to have less bargaining power. The framework advanced in this work is adaptable to different circumstances, in keeping with the fluid and complex nature of the subject – international taxing rights allocation. Although the test is strongly founded on entitlement, it offers a suitable alternative to those fairness perspectives of international taxing rights allocation that draw on cosmopolitan redistribution.

The method of this work is inductive. Drawing from that reasoning pattern, I argue that inter-nation equity is ultimately a manifestation of “reasonableness”. This implies that inter-nation equity addresses the pivotal question: “to what extent is it ‘reasonable’ for a country to give up taxing rights?” To break it down, I claim as follows: (1) the right to tax is inherent, and it is attributable to an amalgam of economic and political demonstrations of sovereignty over the taxable factor, whether person or thing; (2) the international tax regime is a product of political

compromise of tax jurisdiction; (3) a compromise impairs the exercise of inherent tax jurisdiction by sovereign states, often so for the avoidance of the common problem of international double taxation (4) a tax compromise is only just and equitable if it does not *unreasonably* impair the exercise of inherent tax jurisdiction. This induction, in my view, is the basic sense of inter-nation equity. The "reasonableness" factor can be ascertained by assessing a number of factors which are examined in subsequent chapters of this thesis.

In propagating the "reasonable impairment compromise" concept, no claim is made that other approaches are unsuitable to address inter-national tax equity issues. Rather, the goal of this perspective is to isolate the aid narrative, to emphasize the vitality of an entitlement narrative and, in between, to highlight the potential implications of conflating the two perspectives.

For the rest of chapter 1, I review scholarly perspectives on equity in international taxing rights allocation. I consider only contributions that border on the allocation of taxing rights to LIDCs. I contemporaneously consider the potential implications of the existing literature. In chapter 2, I discuss the concept of "reasonable impairment compromise", as a framework for evaluating inter-nation equity. I utilize current issues arising from the restriction of source country taxation of some categories of income, e.g., interest, dividends, royalties, and international shipping, as useful case studies in the process of developing the "reasonableness test" of "reasonable impairment compromise". What follows this doctrinal analysis, in chapter 3, is a more in-depth application of "reasonable impairment compromise" to evaluate a most significant international tax subject of our time – taxation of the digital economy – and the emerging multilateral compromise that allocates taxing rights in that regard. Chapter 4 concludes the conversation.

1.2 The Normative Case for Inter-national Tax Equity and Its Implications for Taxing Rights Allocation Discourse

The international tax literature is awash with material that advocates "fair", "just", or "equitable" taxing rights allocation for LIDCs (inter-nation equity). There is a plurality of perspectives on how we can make the international tax regime do a better job of allocating taxing rights between countries, especially between LIDCs and HIDCs. These perspectives can, however, be subsumed into two broad clusters. The first cluster leans on certain underlying factors – political, economic, and administrative – to ascertain whether there is a legitimate basis or justification (normative entitlement) for a state to exercise tax jurisdiction and, thereupon, focuses on preserving the taxing rights of that state in the face of competing taxing rights claims from other states. This perspective focuses on articulating whether an LIDC has normative entitlement to tax and then emphasizes the importance of preserving that entitlement, within the framework of a cohabitational and collaborative international tax system. It is this perspective that I elaborately explore in chapter 2. But for the purposes of this preceding segment, I would highlight that the entitlement narrative is reflected in an array of scholarship that focuses on how the international tax regime (or tax treaties) unjustly, unreasonably, or disproportionately fetters the taxing rights of LIDCs and, in some cases, transfers those taxing rights to HIDCs.[15] An example is Julia Braun's

[15] See, e.g., Alex J. Easson, International Tax Reform and the Inter-Nation Allocation of Tax Revenue (Wellington, NZ: Victoria University Press, 1991) at 20 [criticizing the lopsided structure of model tax treaties as a reflection of the self-centered biases of the countries that formed the regime – predominantly capital exporters – for greater residence-based taxation and arguing for some "redistribution" as a way to achieve some form of inter-nation equity]. Likewise, the respective works of Hearson and Mutava help to tackle international tax inequity by demonstrating some of the treaty negotiating factors that surround the loss of taxing rights by developing countries. See Martin Hearson, "When Do Developing Countries Negotiate Away their Corporate Tax Base" (2018) 30:2 J Int'l Dev 233 and Catherine Ngina Mutava "Review of Tax Treaty Practices and Policy Framework in Africa" (2019) ICTD Working Paper 102. See also Diane Ring, "Democracy, Sovereignty and Tax Competition: The Role of Tax Sovereignty in Shaping Tax Cooperation" (2009) 9:5 Fla Tax Rev 555 at 584 ["Bilateral double tax treaties face scrutiny as inappropriately favoring capital exporting nations through their allocation of primary and residual taxing rights. Developing countries reportedly have made "concessions" in tax treaties without a full awareness of their implications because they believed the provisions were standard and because the provisions were formally reciprocal (enhancing their appearance of mutuality and comparable impact)".]; Patrik Emblad, "Power and Sovereignty. How Economic-

analysis of 37 tax treaties between Austria and LIDCs, which shines the spotlight on how Austria's restrictive treaty practices rob LIDCs of source taxing rights in some cases "even below the standards embodied in the OECD Model".[16] Another quintessential example is the often-cited piece by Kim Brooks and Richard Krever which vigorously exposes the detrimental role that tax treaties play in depriving LIDCs of source tax revenue and casts significant doubts on the prudence of LIDCs entering into tax treaties with HIDCs.[17] The authors emphasize the preeminent right of LIDCs, as source countries, to tax income at origin and urges them to "fiercely guard their jurisdiction to tax".[18] Yet another example, Vet, Cassimon, & de Vijver's qualitative research piece, exposes how HIDCs, together with powerful business interests, developed certain important transfer pricing soft laws – the transactional profit split method – that would essentially undervalue the contributions of LIDCs to the global value chains of MNEs. The piece highlights how some

Ideological Forces Constrain Sovereignty to Tax" (2021) 4:1 Nordic J L & Soc'y 1 at 8 [suggesting that inter-nation equity is about stopping the redistribution of tax revenue from poor to rich countries].

[16] Julia Braun, "The Effects of Double Tax Treaties for Developing Countries. A Case Study of Austria's Double Tax Treaty Network" (2016) 16:4 Pub Fin & Mgt 383 at 384 ["At the same time, there is a different discussion coming from the perspective of developing countries, calling for a more fundamental 'rethinking' of the international tax system. The question is raised as to how the international tax system generally and Double Tax Treaties (DTTs) in particular impact developing countries. It is being discussed whether developing countries at all benefit from the signature of DTTs under current internationally accepted standards"].

[17] Kimberly Brooks & Richard Krever, "The Troubling Role of Tax Treaties" in Geerten Michielse and Victor Thuronyi, eds, *Tax Design Issues Worldwide*, (The Netherlands: Kluwer Law International, 2015), (chapter 6) 159 at 162. The authors contend that since the source country (LIDC) always has the "initial potential tax jurisdiction", an LIDC-HIDC tax treaty can only result in a surrender or redistribution of that right to the residence country (HIDC). For similar views on the pre-eminence of source country taxation, see Eden *supra* note 6; Luzius U Cavelti, Christian Jaag & Tobias F Rohner, "Why Corporate Taxation Should Mean Source Taxation: A Response to the OECD's Actions Against Base Erosion and Profit Shifting" (2017) 9:3 World Tax J 352. If a source country's statutory tax rate has been limited by a tax treaty, a return to or reflection of the original position should not be portrayed in terms that connote charitable redistribution. But see also, Eric Zolt, "Tax Treaties and Developing Countries" (2018) 72 Tax L Rev 111 [arguing that tax treaties are not likely to result in the redistribution of tax revenue from LIDCs to HIDCs, but are instead a mechanism for easing the tax burdens of their TNCs]. The constant in these views is that a tax treaty generally results in the loss of source tax revenue by LIDCs. It makes no revenue difference (to the LIDC) whether the lost tax revenue is claimed by MNE or its residence country.

[18] *Ibid* at 161.

countries on the receiving end of these lopsided rules are pushing back by introducing things like "location specific advantages" into their transfer pricing rules to preserve their taxing rights.[19]

The narrative in these pieces – and many alike – revolves around the resistance, amelioration or eradication of overlaying international tax standards that hinder the capacity of LIDCs to exercise their inherent taxing rights with respect to cross-border economic activities.[20] As I demonstrate in chapter 2, these overlaying standards are typically products of political compromise, where the bargaining might of LIDCs is dwarfed by that of HIDCs. Thus, a proper understanding of inter-national tax equity necessarily entails a robust appreciation of the role that economic and political power distribution plays in the entrenchment of international tax norms and standards, and how these norms and standards contribute to robbing LIDCs of the revenues that they should be entitled to mobilize.[21]

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[19] Cassandra Vet, Danny Cassimon & Anne Van de Vijver, "Getting the Short End of the Stick: Power Relations and Their Distributive Outcomes for Lower-Income Countries in Transfer Pricing Governance" in IJ Mosquera Valderrama, D Lesage & W Lips, eds, *Taxation, International Cooperation and the 2030 Sustainable Development Agenda,* United Nations Series on Regionalism 19 (Cham: Springer, 2021) 3.

[20] Examples are proposals to change profit allocation rules that are especially detrimental to domestic revenue mobilization in LIDCs. See, for instance, Michael C Durst, "Developing Country Revenue Mobilisation: A Proposal to Modify the 'Transactional Net Margin' Transfer Pricing Method" (2016) ICTD Working Paper 44; Tommaso Faccio & Sol Picciotto, "Alternatives to the Separate Entity/Arm's Length Principle for Taxation of Multinational Enterprises" (2017) ICRICT Briefing Paper; David Quentin, "Corporate Tax Reform and "Value Creation": Towards Unfettered Diagonal Re-allocation across the Global Inequality Chain" (2017) 7:1 Acc Econ & L 1; Vet, Cassimon & de Vijver *supra* note 19. Also, Deepal Kapoor, "The MFN Clause in Tax Treaties is Jeopardising Tax Revenue for Lower-Income Countries", *ICTD* (23 August 2021) online: https://www.ictd.ac/blog/mfn-clause-tax-treaties-jeopardising-tax-revenue-lower-income-countries/.

[21] See Emblad *supra* note 15. The recent book by the political economist Martin Hearson has an excellent title that aligns with this narrative. Martin Hearson, *Imposing Standards: The North-South Dimension to Global Tax Politics* (New York: Cornell University Press, 2021). It may not have been as obvious in 1972 when the Musgraves published their landmark paper, but we have become better apprised of the dire effects of 'imposing standards' that effectively rob LIDCs of taxing rights. See Dirk Broekhuijsen & Henk Vording, "What May We Expect of a Theory of International Tax Justice?", in D de Cogan & P Harris, eds, *Tax Justice and Tax Law: Understanding Unfairness in Tax Systems* (Oxford: Hart Publishing, 2020) 155 at 160 ["Nevertheless, the attractiveness of some international tax equity norm that would support the taxing rights of (developing) source countries is evident. The Musgraves' proposal to found an 'inter-nation tax equity' norm was not taken up quickly, perhaps because it did not address a problem felt to be urgent at the time. That only changed over the last two decades, and NGOs like Oxfam and Tax Justice deserve credit for it"].

However, there is a second cluster of literature that is more focused on advocating the use of the international tax system as a tool for revenue transfer or redistribution between HIDCs and LIDCs, with the aim of attaining various liberal, humanitarian, or developmental objectives. In the analysis that follows, I argue that this cluster of literature, perhaps inadvertently, poses a narrative problem for the overarching case for international tax justice that it purports to advance. In sum, this narrative problem manifests as two sides of a coin. On the one hand, the literature tends to channel the fairer taxing rights allocation claims of LIDCs through a prism of charitable redistribution – denoting wealth or revenue transfers from rich to poor countries – even when LIDCs have a normative entitlement to tax. In my view, this charity-laden narrative flows from a wrong premise when the LIDC has a legitimate basis to tax in the first place. On the other hand, the literature, when examining the subject of international taxation and development, fails to adequately distinguish between the accrual of taxing rights to LIDCs and their preservation thereof, as a matter of inter-nation equity, and the use of special tax schemes that transfer developmental (tax) aid from rich to poor countries. Such comingling of unidentical policy goals implicitly casts the entire scheme of taxing rights allocation in the likeness of charity and overcomplicates the discourse around international taxing rights reform. It also undersells the strength of the normative entitlement of LIDCs to tax economic activities that occur in their territory.

In this part of the discussion, I highlight and discuss some scholarly perspectives that epitomize the narrative problem identified above. I would like to begin with a two-decade old remark by a prominent international tax justice scholar, Reuven S Avi-Yonah, made in support of a practical advancement of inter-nation equity:

> The concept of inter-nation equity can be given practical meaning in the design of international tax rules if it is interpreted as embodying explicit redistributive goals. More

> specifically, when a choice is presented between two otherwise comparable alternative rules, one of which has progressive and the other regressive implications for the division of the international tax base between poorer and richer countries, the progressive rule should be explicitly preferred to the regressive one. In the absence of a world taxing authority that can redistribute tax revenues directly, and given the paucity of foreign aid from developed to developing countries, such a concept of inter-nation equity has the best chance of achieving meaningful distributive goals.[22]

It is not obvious whether the intent here is to portray what appears to be a clamor for a more equitable tax revenue allocation as a like-for-like substitute for foreign aid, but the comingling of the two in this case creates an impression that measures that are designed to ensure greater retention of source taxing rights by LIDCs can be as well regarded as development aid or assistance from HIDCs.

A similar narrative can be found in another tax scholar, Ilan Benshalom's proposal to use international tax rules to advance an international redistributive agenda with respect to two issues: taxing interest payments and corporate income tax.[23] The author recommends that rich resident countries wholly forgo their right to tax these incomes so that low-income source countries can freely exercise their full rate taxing rights without having to worry about taxpayers moving their investment elsewhere due to the burden of heavy double taxation. Benshalom opines that "allocating more of the right to tax to poorer developing countries is a form of wealth transfer."[24] The two forms of "wealth transfer" envisaged in this waiver are revenue and development.[25] The author notes that "the redistributive effort can be either an independent enterprise to reduce

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[22] Reuven S Avi-Yonah, "Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State" (2000) 113:7 Harvard L Rev 1573 at 1650. The author supports this proposition with the assessment that "some of the current practice of international taxation can be interpreted as reflecting concern for the relatively greater revenue needs of poorer countries. In particular, the widespread acceptance of the source country's right to levy its tax first and of the imposition of the burden of alleviating double taxation on the residence country partly reflects the position of the poorer (capital-importing) countries in the 1920s" – at 1649.
[23] Ilan Benshalom, "How to Redistribute Critical Examination Mechanisms Promote Global Wealth Redistribution" (2014) 64:3 Uni Toronto LJ 317 at 320.
[24] *Ibid* at 334.
[25] *Ibid* at 334–335.

inequality and poverty or part of a greater, international coordinative deal in which the redistributive policy supplements other coordinative policies."[26]

Likewise, Infanti argues that discussion of inter-nation equity has focused more than is necessary on using on the benchmark of relative per capita income between countries as a basis for income redistribution.[27] The author contends that this approach is limited because per capita income does not adequately demonstrate the state of a country's needs for tax revenue. He advocates that human development index (HDI), or human development report (HDR), should, instead, be leveraged to make decisions about development policy. The author reckons that richer countries can then use the HDI information to determine where and how to channel tax aid to poorer countries.

Infanti opines that tax expenditures such as foreign tax credits and exemptions granted by a resident country and withholding tax concessions granted by a source country – through domestic legislation or tax treaties – constitute tax aid to the other country (or treaty partner). Indeed, Infanti asserts that this is something that countries already do, but not in the tailored manner that is required to improve human development. The author proposes the use of a sliding scale by countries to stipulate how recipient countries can benefit from tax expenditures. The sliding scale ties tax aid to a country's HDI profile. In the case of a sliding scale applied by a source country:

> This would result in the source country ceding more of the national gain (i.e., providing more foreign aid) to the residence country as it performs better in the HDR's human development measures. In this way, the source country would encourage all countries whose residents invest capital there to work to advance human development.[28] [emphasis added]

[26] *Ibid* at 319.
[27] Anthony Infanti, "Internation Equity and Human Development" in Y Brauner & M Stewart, eds, *Tax Law and Development* (Edward Edgar Publishing, 2013) 209.
[28] *Ibid* at 231-232.

By ceding a greater share of the national gain, the source country allows the residence country to claim a greater share of the gain through taxation for use in ongoing development efforts.[29] However, the author suggests that:

> The highest withholding tax rates could be applied to residents of countries that either (1) appear in the HDI's 'low human development' category and fare poorly in the 'HDI improvement rank', or (2) experience losses in HDI due to inequality (as measured by the IHDI) and in achievement due to gender inequality (as measured by the GII) above a specified threshold. This would result in the source country retaining a greater share of the residence country's national gain as it performs more poorly in the HDR's human development measures.[30]

Likewise, residence countries can apply a sliding scale to cede taxing rights in favor of source countries with low HDI, provided that those source countries continue to prudently utilize the "tax aid" to deliver the requisite development.

> A residence country could encourage investment in source countries doing well in terms of human development by exempting income sourced in those countries from tax. It could discourage investment in source countries doing poorly in terms of human development by providing no more than a deduction for foreign taxes paid (or for the worst offenders, by denying relief from double taxation)".[31]

The author opines that "if a country is not significantly advancing human development, it is not likely to be an appropriate target for (direct or indirect) development assistance given the strong possibility that any assistance might not actually be used to advance development".[32] Therefore, countries that fail to fulfill the development agenda to their populace may be denied further tax aid. This would discourage taxpayers from investing in those countries.

In the case of "aid" provided by source countries, Infanti opines that investors who reside in countries that fail to further domestic development would be denied benefits. This may entail

[29] *Ibid* at 233
[30] *Ibid* at 232
[31] *Ibid* at 234.
[32] *Ibid* at 235

taxing the residents of such countries at a higher rate than they enjoy under this proposed tax regime. These exclusionary measures would ensure that only the governments of low-HDI countries that utilize the money to improve HDI will be able to claim the 'tax aid'.

Labelling things like foreign tax credits and tax sparing as "tax aid" (or wealth transfers) to LIDCs is demonstrative of the narrative problem that trails inter-nation equity discourse.[33] In my respectful dissent, Infanti's conceptualization of "aid" can only mean "aiding" or "assisting" another country to fulfill its tax policy objectives. In that sense, "aid" rides the same boat as one country providing taxpayer information to another country to enable the latter ascertain the true tax liabilities of certain taxpayers. It is difficult to conceive "aid" as wealth transfers from one country to another, especially in the case of residence application. How can it be deemed a wealth transfer when the other ("recipient") country is already entitled to tax the income? Again, in the case of residence application, I must ask, is it the residence country's willingness to grant a foreign tax credit that <u>entitles</u> the source country to tax national gains from investment in its territory?[34] If

[33] See Jinyan Li, "Improving Inter-Nation Equity through Territorial Taxation and Tax Sparing" in AJ Easson & AJ Cockfield, eds, *Globalization and its Tax Discontents: Tax Policy and International Investments: Essays in Honour of Alex Easson* (Toronto: University of Toronto Press, 2010) 117 at 128–129 [describing tax sparing as an "international redistribution mechanism"]. See also, Kaufman *supra* note 5 at 153 ["it would be a mistake to think of internation equity in taxation only in terms of <u>entitlement theory</u>. The number of capital-exporting countries now granting tax-sparing credits in treaties with developing countries indicates an acceptance of a certain degree of redistribution within the international tax system. Distributional considerations are more at home in a welfarist view of economic justice"]. In the first place, most resident countries recognize the right of the source country to tax the income and would normally grant a tax credit or exemption in recognition of that right. See Kim Brooks, "Tax Sparing: A Needed Incentive for Foreign Investment in Low Income Countries or an Unnecessary Revenue Sacrifice" (2009) 34:2 Queen's LJ 505. Does the fact that the source country, for some policy reason, opts to not tax make it the income of the resident country to "redistribute"? Would that not be tantamount to being given what one was *ab initio* entitled to tax? A situation where a residence country taxes spared revenue seems more like redistribution from the source country to the residence country.

[34] Conversely, not granting a tax credit, for instance, does not have any bearing on the source country's normative entitlement to tax the gain (the bedrock of inter-nation equity, according to the Musgraves). Instead, it may be regarded as a tax policy choice which leaves the source country with the options of (double) taxing the gain or not taxing it, in the latter case as a trade-off for other benefits of foreign capital. Ultimately, what the residence country's policy can achieve is to channel the flow of investment – not confer taxing rights – towards or away from the source country. It is in this context of opening trade and investment opportunities that Christians uses the term "aid" to examine U.S. tax policy – or the lack of – towards sub-Saharan Africa. See Allison D Christians, "Tax Treaties for Investment and Aid to Sub-Saharan Africa – A Case Study" (2005) 71:2 Brook L Rev 639. See also Karen B Brown, "Missing Africa: Should U.S. International Tax Rules Accommodate Investment in Developing Countries?" (2002) 23:1 U Pa J Intl

not, then can we accurately regard the tax expenditure[35] as aid (wealth transfer) to the source country or should we instead regard it as a measure that recognizes an overriding imperative to not erode the source country's tax base or frustrate its underlying tax policy? In that sense, the "assisting country" is offering a "tax policy aid", rather than "tax aid".[36] The same goes for the proposals by Avi-Yonah and Benshalom.

Perhaps, what the unfiltered aid narrative also seems to ignore is the fact that commercial entities that operate overseas (including in LIDCs) assume the principal objective of profiting from their overseas exertions and that their profits constitute national gains for their home countries, regardless of whether the home country chooses to tax.[37] Note, for instance, the position expressed by U.S. law professor, Robert Hellawell, in 1966, whence, while extoling the U.S. tax code's "favoritism toward investment in less developed countries" as "an important part of our foreign

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Econ L 45 [imploring the U.S. to use favorable multilateral tax treaties to direct investment towards sub-Saharan African countries for a specified period to accelerate development in those countries]; Calvin J Allen, "United States Should Expand Tax Treaty Network in Sub-Saharan Africa" (2004) 34 Tax Notes Int'l 57 [also urging the U.S. to enter into tax treaties with African countries to facilitate trade and investment. The piece also adumbrates various mutual benefits of entering into such tax treaties]. Also, residence taxation (with full foreign tax credit) serves a different purpose of CEN, which means that investors can base their location decisions on before-tax returns as their home state determines their tax burden. See Broekhuijsen & Vording *supra* note 21 at 159. In any case, as Brooks & Krever observe, countries have long and strategically embraced a policy of granting these benefits to their residents investing overseas. See Brooks & Krever *supra* note 17. This practice preceded the advent and proliferation of tax treaties in the early-to-mid 20th century. See Michael J. Graetz & Michael M. O'Hear, "The "Original Intent" of U.S. International Taxation (1997) 46 Duke L.J. 1021; Katja Pauwels, "The Benefits of Tax Treaties and Foreign Tax Credits in Sub-Saharan Africa" (2008) Tax Notes Int'l 447.

[35] "Better known as tax breaks or loopholes, tax expenditures are deviations from the normal tax structure "designed to favor a particular industry, activity, or class of persons" They take the form of deductions, exemptions, exclusions, deferrals, credits, or preferential rates" – David E Pozen, "Hidden Foreign Aid" (2007) 8:6 Fla Tax Rev 641 at 642, quoting the originator of the concept Stanley S Surrey & Paul R McDaniel, *Tax Expenditures* (HUP, 1985) at 3.

[36] The phrase "tax policy aid" (otherwise "tax policy 'support' or 'assistance'") describes a situation where one country bends its tax rules in a certain way to accommodate the success of another country's tax policy. The other country's policy may be geared towards a range of objectives, including, increased revenue (e.g., higher business profits tax rates), investment attraction (tax incentives), or technology imports (lower withholding tax rates on royalties). The residence country provides policy support through foreign tax credits, tax sparing and (again) tax sparing [do you mean tax sparing twice?], respectively. Despite the policy support (which may entail a revenue loss), the residence country benefits from the national gains (in capital) that accrue to its residents from their overseas trading and investments.

[37] Musgrave & Musgrave *supra* note 8 [arguing that yields from overseas business carried out by a country's residents constitute a national gain to that country regardless of whether the residence country chooses to impose a tax on the gain; and if it does tax the gain, then the taxed portion becomes a revenue gain].

aid program", also acknowledged that the favorable tax treatment granted U.S. business had another important purpose: to help develop new foreign markets for American exports, investments, and other commercial interests.[38] Indeed, during the post-war negotiations for the formation of a global double tax regime, the U.S., despite being a major creditor/capital exporting country, was willing to accept a more pro-source country taxation structure because of its conviction that more overall net gains would accrue from the unhindered export of U.S. commerce; and this would also empower the debtor countries to sort out their indebtedness to the U.S.[39] This not-so-charitable disposition, perhaps, underscores the Musgraves' dismissal of residence countries' tax treatment as a relevant constituent of inter-nation equity.[40]

More recently – coinciding with the OECD BEPS project – the urgency of revenue mobilization to further the implementation of the United Nations Sustainable Development Goals (UN SDGs) in LIDCs has featured prominently as a justification for global tax revenue redistribution.[41] While programs like the SDGs do provide tax scholars something extra to strengthen the case for international tax reform, it is equally important for scholars to make clear that these humanitarian concepts are not the foundations upon which the taxing rights claims of LIDCs are based.

[38] Robert Hellawell, "United States Income Taxation and Less Developed Countries: A Critical Appraisal" (1966) 66 Colum L Rev 1393).

[39] See Ring *supra* note 2. To buttress this point, we can draw from the U.S. Trade and Development Act of 2000 which states in its introduction that it is an act "to authorize and new trade and investment policy for Sub-Saharan Africa". Section 102 of the Act states, *inter alia,* that (1) it is in the mutual interest of the United States and the countries of sub-Saharan Africa to promote stable and sustainable economic growth and development in sub-Saharan Africa".

[40] Musgrave & Musgrave *supra* note 8 at 69; Brooks, "Internation Equity" (2009) *supra* note 8 at 474.

[41] See, for instance, Alex Cobham, Tommaso Faccio & Valpy Fitzgerald, "Global Inequalities in Taxing Rights: An Early Evaluation of the OECD Tax Reform Proposals" (2019) SocArXiv Paper; Alexander Ezenagu, "Unitary Taxation of Multinationals: Implications for Sustainable Development" (2019) CIGI Policy Brief No. 4; Martin Hearson, Joy W Ndubai & Tovony Randriamanalina, "The Appropriateness of International Tax Norms to Developing Country Contexts" (2020) FACTI Background Paper 3; Tarcísio Diniz Magalhães & Ivan Ozai, "A Different Unified Approach to Global Tax Policy: Addressing the Challenges of Underdevelopment" (2021) 4:1 Nordic JL & Society 1 at 18; Sarah Ganter, "Digital Taxes for Sustainable Development?" (2021) 38:1 Digitalization & Sustainability 49.

Regrettably, the framing of some of the taxation and development scholarship does not always exert sufficient effort to illuminate this important conceptual distinction.

An example is Stewart's identification of "concessional tax treaty rules" as one of the mechanisms through which rich countries can discharge their obligation to help poor countries develop.[42] It goes without saying that this characterization conveys the impression that "concessional tax treaty rules", such as higher source withholding tax rates on passive income for LIDCs, which essentially enable LIDCs to retain a greater share of outbound payments, constitute financial aid from rich to poor countries. Is this really the case?

Some prominent criticisms of the OECD BEPS project reference its failure to cater to the needs of developing countries to raise resources to meet their commitment to the UN SDGs.[43] The piece by Christians & Magalhães does a crucial job of demonstrating how the "Unified Approach" proposal released by the OECD Secretariat in late 2019 was skewed to reserve most tax gains arising from the digital economy to major market jurisdictions (mostly HIDCs).[44] The scholars then advocate that the proposal should instead incorporate "other pressing international policy programs that are simultaneously under development, most notably a global commitment to building institutions that support sustainable economic development."[45] Standing on the premise that political calculations largely determine the technicalities of tax rules, the authors implore countries to channel their political will towards aligning the technical rules, under the current reform, with the need for revenue mobilization in LIDCs, in order to "meet the targets for sustainable and inclusive growth and development".[46] Such an approach, the authors reckon, would help to avoid the "distributional

[42] Miranda Stewart, "Redistribution Between Rich and Poor Countries" (2018) 72:4/5 IBFD Bull for Intl Tax'n 297.
[43] Allison Christians & Tarcísio Diniz Magalhães, "A New Tax Deal for the Digital Age" (2019) 67:4 Canadian Tax Journal 1153.
[44] *Ibid* at 1176.
[45] *Ibid* at 1175.
[46] *Ibid* at 1176.

impacts of the flawed system that the tax policy architects of the early 20th century forged to satisfy the political preferences of their day."[47]

The authors express dismay that "given that the United Nations, the OECD, the International Monetary Fund, the World Bank, and other key policy-making bodies, in addition to taking notice of the rise of digitalization as a global phenomenon, have simultaneously identified the need to mobilize revenue in developing countries in order to meet targets for sustainable and inclusive growth and development…" it is surprising that "these goals seem nowhere to be found among the various discussions surrounding the urgent need for action in redefining taxing rights in the name of fairly sharing the tax base among all members of the Inclusive Framework."[48]

Mosquera, Lesage & Lips support the calls to align international tax reform – through the OECD BEPS project – with the SDGs.[49] However, their proposal bases reform of source-restrictive pro-residence bilateral tax treaties on the SDGs resource mobilization rationale. They charge both developed and developing countries to beware of the impact of these arrangements and reckon that "[t]he BEPS follow-up discussion on digital economy, for example, is one where the OECD has an explicit mandate to rebalance source and residence taxation in a new part of the economy."[50]

Similarly, Eyitayo-Oyesode strongly contends that the restrictive source rules contained in the tax treaty framework, generally, and in Nigeria's tax treaties, specifically, infract on the inter-nation equity principle and are, therefore, unjust to LIDCs, especially because these rules lead to

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[47] *Ibid.*
[48] *Ibid* at 1176–1177.
[49] Irma Johanna Mosquera Valderrama, Dries Lesage & Wouter Lips, "Tax and Development: The Link between International Taxation, The Base Erosion Profit Shifting Project and the 2030 Sustainable Development Agenda" United Nations University ICRIS Working Paper Series W-2018/4 (2018).
[50] *Ibid* at 22.

significant revenue losses in LIDCs.[51] The author expresses disillusionment with the fact that this issue is not given the required attention in international fora. She advocates that the OECD BEPS project, which is tackling the issue of "treaty abuse" should expand "treaty abuse" to include "situations where profits which, otherwise would have become taxable in source countries, are being shifted to resident countries based on the provisions of tax treaties."[52] The author proceeds to contend that "although the UN is discussing the fulfillment of the Sustainable Development Goals in developing countries, there has been no discussion around the reform of the allocation rules which would secure more tax revenue for developing countries to aid, among others, their efforts to achieve those development goals".[53]

In the piece entitled "Linking Policies: Inter-Nation Equity, Overseas Development Assistance, And Taxation", Brazilian tax scholar, Falcão, highlights some correlation between inter-nation equity and overseas development assistance (ODA).[54][55] She asserts that "bilateral tax treaties are concerned with tax base allocation between states, splitting them into source and residence countries", but notes that "within the realm of ODA… the primary concern is redistribution and assistance granted by rich countries to poor. However, redistribution is significantly affected by tax considerations... If improperly attuned, the interaction between redistribution and taxation — two seemingly distinct but parallel cash flow and transfer networks — can create a system that first allocates most (or as many as possible) taxing rights to the resident state, and then requires

[51] Oladiwura Ayeyemi Eyitayo-Oyesode, "Source-Based Taxing Rights from the OECD to the UN Model Conventions: Unavailing Efforts and an Argument for Reform" (2020) 13:1 L & Dev Rev 193.
[52] *Ibid* at 225.
[53] *Ibid*.
[54] Tatiana Falcão, "Linking Policies: Inter-Nation Equity, Overseas Development Assistance, And Taxation" (2018) 19:12 Tax Notes Intl 1211.
[55] The OECD defines the alternative phrase "official development assistance" (ODA) as grants or loans in foreign countries and territories (developing countries) and multilateral agencies active in development that are: "undertaken by the official sector; with the promotion of economic development and welfare as the main objective, at concessional financial terms" Richard Manning, *Development Co-operation Report* (Paris: OECD Publishing, 2005) at 260.

the residence state to donate a part of the accumulated resources to the source state through direct or indirect transfers in the form of ODA".[56]

The author further observes that ODA does not allow low-income countries to claim "national ownership" over projects and that a better way to effect redistribution is through the tax system. The author proposes that both the OECD and the UN model tax treaties be revised to redistribute taxing rights, to mobilize the tax revenue needed by LIDCs to self-develop. Citing already existing examples, the author concludes that this objective can be implemented by a broader scale adoption of bilateral tax treaty structures through which HIDCs "concede to an uneven allocation of source taxing rights, particularly when entering into a treaty with a developing country."[57]

I do not dispute the substance of these contributions, nor the good intentions of the authors. My sole concern here is that when the conversation is framed in these (hybridized) terms, it may become difficult to distill whether the contention is that international tax rules ought to be changed because they unjustly restrict the taxing rights of LIDCs (inter-nation equity) or that the rules are not unjust, but should be changed to channel developmental aid from HIDCs to LIDCs, perhaps, because even the "fair share" being received by LIDCs is not sufficient to address their developmental goals. The latter case implies that the rules are not unfair, despite their restrictiveness, but they ought to be adjusted, nevertheless, to provide tax aid to LIDCs. I must, therefore, stress that as well-intentioned and well-articulated as these pieces may be, their narrative has an implicit potential to provoke the portrayal of equitable taxing rights allocation to LIDCs as tax aid schemes between rich and poor countries or, otherwise obscures the entitlement claim of LIDCs in the face of a "redistribution" objective. It potentially conveys the impression that LIDCs'

[56] *Ibid* at 1211.
[57] *Ibid* at 1215.

engagement with the OECD BEPS project, for instance, is not about eradicating base erosion that arises from the inequitable design of existing inter-nation tax norms (which tends to favour HIDCs), but a cap-in-hand mission for developmental tax aid. The narrative might even be considered counterintuitive given that it is implicit that the whole idea of a BEPS project is to eradicate base erosion, of all forms, which would ultimately amount to greater profiles of retained revenue. The narrative, therefore, undersells and, perhaps, displaces a more robust approach to the equity problem: the view that fairer allocation of taxing rights is founded on entitlement thought and is principally about eradicating or ameliorating structures in the international tax regime that unjustly fetter the rights of LIDCs to tax income that originate from their territory.

Inter-nation equity, in this regard, should resonate as a guardrail to unreasonable surrender of tax jurisdiction, detachable from the embellishment of welfare aspirations like the SDGs. A tax reform claim that is normatively anchored on "sustainable development" may unintendedly weaken the bargaining position of LIDCs because of the endemic theoretical bottlenecks of establishing obligations of global distributive justice[58], or even a less intrusive "duty of assistance" from rich countries to poor countries.[59] At best, such a duty is no more palpable than what may be expected

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[58] See Menno R Kamminga, "Why Global Distributive Justice Cannot Work" (2006) 41 Acta Politica 21; Miriam Ronzoni, "Global Tax Governance: The Bullets Internationalists Must Bite—And Those They Must Not" (2014) 1:1 Moral Philosophy and Politics 37 at 45. For a comprehensive but concise discussion of global distributive justice perspectives, see Simon Caney, "International Distributive Justice" (2002) 49:5 Pol Stud 974. The main school of global distributive justice is cosmopolitanism. According to Carney, cosmopolitans generally agree or contend that: (a) individuals have moral worth, (b) they have this equally, and (c) people's equal moral worth generates moral reasons that are binding on everyone. If we accept these (very plausible) ethical claims it would be mysterious to claim that the duties imposed by a theory of justice should include only fellow citizens or fellow nationals. These universalist considerations imply that the scope of distributive justice should be global; and a person's nationality or citizenship should not determine their entitlements. *Ibid* at 977–979. See also, Thomas Pogge, *Realizing Rawls* (Ithaca, NY: Cornell University Press, 1989); Brian Barry, "Humanity and Justice in Global Perspective" in *Liberty and Justice: Essays in Political Theory*, Vol 2 (Oxford: Clarendon, 1991) 182; Charles Beitz, *Political Theory and International Relations* (Princeton, NJ: Princeton University Press, 1999); Gillian Brock, "What Burden Should Fiscal Policy Bear in Fighting Global Injustice?" in HP Gaisbauer, Schweiger & C Sedmak, eds, *Philosophical Explorations of Justice and Taxation,* Vol 40 (Switzerland: Springer Int'l Publishing, 2015).

[59] There has been much philosophical debate about whether HIDCs have a duty to assist LIDCs ('burdened societies') to overcome endemic socioeconomic burdens. The "duty of assistance' theory is credited to John Rawls. See John Rawls, *The Law of Peoples with "The Idea of Public Reason Revisited"* (Cambridge, Mass: Harvard University Press,

in the context of ODA, which is entirely within the discretion of the assisting country; and for which the recipient country has no standing on what, when and how to receive. It is represented in the classic statement "beggars can't be choosers".

So, instead of overcentralizing the notion of redistributing tax revenue from HIDCs to LIDCs (to assist the latter in achieving sustainable development), we can, perhaps, make the issue about reforming international tax norms (e.g., the permanent establishment rule) that impair the rights of LIDCs, as source countries, to tax revenue outflows.[60] This way, the readjustments can be instinctively – and rightly – viewed less as tax revenue transfers from rich to poor countries and more as rectifications of the regressive tax norms that rob LIDCs of tax revenue and, consequently, result in the need for things like the SDGs. Such reframing of narrative can help to defuse

1999). Rawls rejects global distributive justice and argues, instead, that "well ordered peoples" would, for the international scene, operate on eight principles (constituting his Law of Peoples), one of which is a duty to assist other peoples living in unfavorable conditions. The Rawlsian perspective has attracted both critics and defenders in great measure, ranging from those who see it as a betrayal of his earlier positions on (domestic) distributive justice (expressed in the 1971 book, *A Theory of Justice*) to those who regard it as a more sensible/moderate approach to international relations. See, generally, Allen Buchanan, "Rawls's Law of Peoples: Principles for a Vanished Westphalian World" (2000) 110 Ethics 697; John Tasioulas, "From Utopia to Kazanistan: *John Rawls and the Law of* Peoples" (2002) 22:2 Oxford J L Stud 367; Thomas Pogge, "Assisting' the Global Poor", in DK Chatterjee, ed, *The Ethics of Assistance: Morality and the Distant Needy* (Cambridge: Cambridge University Press, 2004) 260; Thomas Pogge, "The Incoherence Between Rawls's Theories of Justice" (2004) 72:5 Fordham L Rev 1739; Thomas Nagel, "The Problem of Global" (2005) 33:2 Phil & Pub Affairs 113; Mathias Risse, "What We Owe to the Global Poor" (2005) 9 J of Ethics 81; Joseph Heath, "Rawls on Global Distributive Justice: A Defence" (2005) 31 Can J Phil, supp 193; Chris Armstrong, "Defending the Duty of Assistance?" (2009) 35:3 Soc Theory & Practice 461; Sylvie Loriaux, "Fairness in International Economic Cooperation: Moving beyond Rawls's Duty of Assistance" (2012) 15:1 Critical Rev Int'l Social & Pol Phil 19; Rex Martin, "Rawls on International Economic Justice in The Law of Peoples" (2015) 127 J Bus Ethics 743. For a review of these varying responses, see Gillian Brock, "Recent Works on Rawls's *Law of Peoples:* Critics Versus Defenders" (2010) 47:1 Am Phil Qtly 85. Without getting entangled in that philosophical debate and without prejudice to their varied plausibility in other respects of international relations, I am of the view that the duty that is integral to international tax equity, so to speak, is that countries, particularly HIDCs, should not impose compromises, standards or structures that erode the tax base of LIDCs. As Ozai rightly observes, "one does not need to embrace a 'non-relational' global cosmopolitanism to hold the current international tax system as morally unjust. An intermediary position on global justice implies that international cooperation requires minimal mutual respect between political communities, which might not imply full global distributive justice but demands the absence of grave injustices". Ivan Ozai, "Two Accounts of International Tax Justice" (2020) 33:2 Can J L & Jurisprudence 317 at 326. To have such a "duty" – that absents grave injustices – engrained in the international tax regime would, in itself, be of tremendous "assistance" to the revenue and, perhaps, developmental, aspirations of LIDCs.

[60] Brooks & Krever *supra* note 17.

extraneous perceptions about the propriety of "wealth transfers" to poor but mismanaged states, as depicted here in the grim observation of American author Adam Rosenzweig:

> There has never been much support in the United States for a policy of significant transfers of tax revenue to taxpayers in India or Bangladesh or Haiti. Part of the intuition underlying this resistance is based on the fact that part of the reason for disparities in income around the world has to do with differences in development, infrastructure, and especially government. For example, it would be expected that a country governed by a corrupt government which spends little on improving general welfare of its residents would have much lower GDP and GDP per capita. Conversely, part of the reason for high U.S. incomes could be due to a generally stable and effective government, including stable currency, legal systems, and physical infrastructure. From this perspective, it might seem absurd for vertical equity to demand transferring revenue from the United States to such a government when the money would be expected to be lost to corruption.[61]

Rosenzweig's assessment makes an important point that no state – however wealthy – can have an easy time of transferring its tax wealth to another state where the wealth is likely to be squandered by corrupt elements. In my view such assessment is defensible only in those situations – demonstrated below – where international tax rules are streamlined to funnel tax revenue to a foreign country (LIDCs) despite the transferee country not enjoying a normative entitlement to tax, whether as a residence or source country. However, if it is the case that an LIDC is normatively entitled to tax the base, even at a level more suitable to its fiscal aspirations, but for extrinsic barriers erected by the international tax regime (e.g., the permanent establishment rule or withholding tax rate caps), then the assessment falls out of place. Otherwise, it would be tantamount to one sovereign depriving another access to its property because the former is of the view that the latter would squander it, while considering itself better endowed with virtue to prudently utilize the property. Metaphorically, any such reference to corruption or mismanagement as a hinderance to equitable taxing rights allocation would be reminiscent of arguments that artifacts looted during colonial occupation should not be returned to their countries of origin

[61] Adam H Rosenzweig, "International Vertical Equity" (2021) 52:2 Loy U Chi LJ 471 at 494.

because those countries' museums may lack the capacity to manage or display the items.[62] For the avoidance of doubt, the existence of "benevolent and capable government" cannot be a prerequisite for the equitable allocation of taxing rights[63]; and this is not just because the right to tax inheres in the sovereign – rather than the individual – but also because a state's entitlement to tax income from economic activities present in its territory is not qualified by how it ultimately utilizes the tax revenue. A state can tax to build, to consume, to develop or even to fund unjust wars. In no case is a state's tax sovereignty or allocation of right to tax dictated – or upended – by its spending choices. Therefore, the question of whether duties of distributive justice accrue to the individual or the state has no bearing on the distribution of taxing rights.

The conclusion that I draw from the analysis thus far is that scholars approach "fairness" issues in international tax from two angles. The first is entitlement. Here, the author is concerned with how countries can structure their taxing rights allocation compromise without a country, especially the LIDC, giving up more tax revenue than is defensible.[64] The second is aid. Here, scholars analyze the fairness issue through the underlying premise of income redistribution.[65] This perspective

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[62] Invicta, "Should Museums Return Artefacts to the Countries they come from?", *Invicta,* online: https://www.invictamobileshelving.co.uk/insights/museums-return-artefacts-countries/

[63] Johanna Stark, "Tax Justice Beyond National Borders — International or Interpersonal?" (2021) Ox J Leg Stud 1 ["Absent a robust assumption of a benevolent and capable government on the recipient side, the reallocation of taxing rights from state to state does not necessarily help when it comes to fulfilling duties of justice towards individuals".].

[64] See Brooks & Krever, *supra* note 17; Braun *supra* note 16.

[65] Drawing from domestic tax parlance, I use the term "redistribution" (or "wealth redistribution") in the context of wealth transfers by the state (essentially from the wealthy) to the poor through the tax system. This is often exercised through the issuance of tax credits and other welfarist forms of tax expenditure to eligible taxpayers. Domestic income and welfare redistribution is a common feature of the tax policies and systems of many countries. See, e.g., Nora Lustig, "Inequality and Fiscal Redistribution in Middle Income Countries: Brazil, Chile, Colombia, Indonesia, Mexico, Peru and South Africa" (2016) 7:1 J Globalization and Dev 17; Orsetta Causa & Mikkel Hermansen, "Income Redistribution through Taxes and Transfers across OECD Countries" (OECD Economics Dept WP 1453, 22 July 2019). A recent example is the US child tax credit contained in the 2021 American Rescue Plan Act. See Ariel J Kleiman, "Revolutionizing Redistribution: Tax Credits and the American Rescue Plan" (2021) Loyola Law School Legal Studies Research Paper No. 2021-27. Redistribution is also deemed to occur through progressive tax rates, which means that those who earn more pay a higher marginal rate of tax. For further discussion of the concept of tax-based redistribution, its feasibility and implementation in various countries, see Rune Ervik, "The Redistributive Aim of Social Policy: A Comparative Analysis of Taxes, Tax Expenditure Transfers and Direct Transfers in Eight Countries" (1998) LIS Working Paper Series No. 184; Richard M Bird & Eric M Zolt, "Redistribution via Taxation:

focuses on how international tax can be used to channel developmental tax aid from HIDCs to LIDCs.[66] The difference between the two perspectives is essentially one of "give and take". While the former frames the message along the lines of "do not take taxing rights (or tax revenue) away from LIDCs", the latter appeals to HIDCs to "give more taxing rights or revenue to LIDCs". One perspective emphasizes the inherence of taxing rights in the LIDC, and seeks to preserve it. The other undermines that entitlement factor by indistinctly portraying equitable taxing rights allocation as a form of tax aid transfer from HIDCs to LIDCs, a potentially unpopular domestic politics subject in HIDCs.[67] So, although the revenue mobilization implication of both perspectives may ultimately be similar, the narratives are not – and there could be consequences.[68]

The way the case is presented may diminish the strength of an entitlement claim. Can LIDCs effectively assert fairer terms in international tax deals if the paramount notion in the negotiation room is that such claims are anchored on charitable considerations? And this is not to state that allocation that references the disparate economic positions of the states is equivalent to charity. As I demonstrate shortly below, with respect to differentiation – more robustly in chapter 2 – it is

The Limited Role of the Personal Income Tax in Developing Countries" (2005) 52:6 UCLA L Rev 1627; Beverly Moran, "Wealth Redistribution and the Income Tax" (2010) 53:2 Howard LJ 319; Richard M Bird & Eric M Zolt, "Taxation and Inequality in Canada and the United States: Two Stories or One?" (2015) 52:2 Osgoode Hall LJ 400; Tom Harris, *et al,* "Redistribution via VAT and Cash Transfers: An Assessment in Four Low and Middle Income Countries" (2018) IFS Working Papers No. W18/11; Elvire Guillaud, Matthew Olckers & Michael Zemmour, "Four Levers of Redistribution: The Impact of Tax and Transfer Systems on Inequality Reduction" (2019) 66:2 Rev of Income & Wealth 444; Pierre Bachas, Lucie Gadenne & Anders Jensen, "Informality, Consumption Taxes and Redistribution" (2020) NBER Working Paper 27429. It seems to me that the notion of redistribution (wealth transfer) does not apply in the context of equitable allocation of taxing rights to LIDCs. As I consistently emphasize, what equity entails for LIDCs is the reform of international tax norms or structures to ease the restrictions that fetter the rights of LIDCs to tax income outflows from their borders.

[66] See, for instance, Benshalom *supra* note 23.

[67] See Rosenzweig *supra* note 61.

[68] In cases where scholars analyze equity through a hybrid of entitlement and redistribution, the approach potentially relegates the perspective of the LIDC's inherent entitlement to tax the income, since it tends to portray tax revenue as aid. The hybrid approach potentially does the same kind of messaging damage as the outright charity narrative.

possible to stress the economic disparities of respective states in taxing rights allocations without conveying the impression of charity.

As a quasi-hypothesis, if the U.K. Parliament is poised to consider the fairness of a tax treaty between the U.K. and Lesotho, "a landlocked poor African country of 2 million people", before ratifying that tax treaty, the U.K. Parliament may raise questions about whether the treaty unduly limits the right of Lesotho to raise tax revenue by giving huge tax breaks to U.K. companies doing business in Lesotho.[69] Crucially, the concern of the U.K. Parliament here should not be construed as a demonstration of its willingness to provide tax aid to Lesotho (perhaps, so that Lesotho can tackle poverty). Instead, the U.K. Parliament's intervention (in the sense of inter-nation equity) should be construed as a reflection of concern over whether the U.K. has, perhaps, used its dominant bargaining position (economic and political) to structure a treaty that unreasonably impairs Lesotho's source tax jurisdiction, thereby, effectively shifting Lesotho's tax base to the U.K.[70]

Again, this is not intended as a rebuke of "aid" or "redistribution" but an illuminating appraisal of the potential implications of how these concepts are used in the context of international tax compromise. Often, the messaging, more than the intent, is the problem. Even though there is goodwill in the cultivation of international tax redistribution, the failure to distinguish between the entitlement and redistributive perspectives undermines the vigour of the entitlement claim. Wealthy countries can deflect from or resist agitations for equitable allocation of taxing rights to LIDCs by asserting that this objective can be achieved, or is already being achieved, through ODA.

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[69] See John Date, "Four Questions MPs Must Ask in Parliament Today About the UK-Lesotho Tax Treaty" (10 January 2018) *Huffington Post,* online: https://www.huffingtonpost.co.uk/entry/uk-lesotho_uk_5a54982be4b0f9b24bf31a7d.

[70] The UK Parliament, in this scenario is also not concerned with how Lesotho spends it tax revenue, as that subject is well within the fiscal sovereignty of Lesotho.

As already demonstrated, an unfiltered fusion of redistribution and equity in the international tax literature cultivates a "handout" mindset in the taxing rights allocation discourse. A reiteration of entitlement thought, on the other hand, displaces or limits the erosive impact of such notions of charitable redistribution by championing reforms that aim to preserve the inherent tax jurisdiction of LIDCs. Such an approach can help to rectify global power abuses that, in any case, have been instrumental in creating some of the global inequities that generated the need for curative policies like the SDGs. Bearing that in mind, if scholars must anchor the allocation of taxing rights to LIDCs to some form of liberal, developmental, or humanitarian objective, it is important to also acknowledge the underlying entitlement of the LIDC to tax, even without such objectives in the fore. This way it becomes self-evident that the appeal to other factors does not substitute or displace the LIDC's inherent tax jurisdiction, but to persuade the HIDC – as the more powerful party – to roll back obstacles that hinder the LIDC from exercising that entitlement. We can take some cue from the piece by Brooks which advocates the entrenchment of redistributive policies in tax treaties between HIDCs and LIDCs for the purpose of advancing the rights and needs of women in LIDCs. Crucially, the author highlights that:

> Whether or not scholars characterize these kinds of arguments as promoting redistribution or as a just allocation of tax revenue depends on their perspective about the normatively correct allocation of income between two countries with differential trade flows. It might be argued that since the residence state could tax the entire international income without granting a credit, the resident state's willingness to sacrifice some revenue to the source state is a form of redistribution (to a low income state). On the other hand, one could argue that the source state is entitled to tax all of the income, and therefore its sacrifice of some revenue to the residence state is a form of redistribution (to the high-income state). Regardless, traditional tax policy approaches to international tax leave room for debate about the appropriate characterization of the allocation function served by tax treaties.[71]

[71] Kim Brooks, "Global Distributive Justice: The Potential for a Feminist Analysis of International Tax Revenue Allocation," (2009) 21:2 CJWL 267 at 284.

By expressly acknowledging these distinctive perspectives, the piece goes some way to douse potential misconceptions that the more favorable allocation being contemplated equates or displaces the idea of normative entitlement as the basis for any claim by the LIDC to better tax relations with the HIDC. The point being made, therefore, is that it is not so much the objective (more revenue for the LIDC) being sought that is problematic, but how it is framed. As afore stated, the revenue mobilization consequences may be similar, but the messaging must also be clear in order to distinguish between the two perspectives.

A similar helping hand is extended by another tax scholar, Ivan Ozai, who asserts that there are two approaches to inter-nation equity in taxing rights allocation: entitlement and redistribution. The author posits that the former is a reflection of tax sovereignty (i.e., origin based) while the latter entails the use of the tax system to attain redistributive objectives. The author presents the concept of differentiation as the way to approach the redistributive goals of international taxation. He concludes that inter-nation equity should be construed to mean that "whenever a normative approach based on tax sovereignty (entitlement approach) does not provide satisfactory guidance for how to divide the international tax base, taxing rights should be allocated to the benefit of less affluent countries so as to address global poverty and inequality (differential approach)".[72]

The above contribution represents a rare but significant attempt to expatiate the theoretical scope of the inter-nation doctrine, despite the pervasive deployment of the doctrine in international tax scholarship. Importantly also, Ozai goes beyond mere doctrinal exposition to demonstrate how differentiation can be used to solve real inter-nation equity problems. For instance, if we are to establish a formula for apportioning the income of MNEs between different source countries, but it is unclear which economic factor(s) (e.g., physical assets, sales, and employees) would best

[72] See Ivan Ozai, "Inter-Nation Equity Revisited" (2020) 12:1 Columbia J Tax L 58 at 60.

indicate the location of value creation for the MNE, the differential principle, according to Ozai, requires that we jettison these inadequate economic metrics and instead apply some economic or human development indicator (e.g., gross domestic product (GDP) or international inequality index) that potentially ensures the best distributive outcomes for LIDCs.[73] I concur with the author to the extent that countries should be treated *differentially* in the apportionment of international taxing rights.[74] I only caution that such an approach, in the manner presented by Ozai, might imply that the apportionment is predicated on a presumed inability to establish a normative entitlement to tax which then necessitates resort to human development factors as a substitute for origin-based entitlement. The approach seems to portray the non-existence of a formula to adequately or satisfactorily allocate income between states as a displacement of the normative entitlement of a state to tax. It seems to me that such an approach may be misconstrued to abdicate any entitlement arguments that an LIDC may assert. Suffice it to state that absent an established normative entitlement to tax, there can be no genuine basis on which to even begin to broker an inter-nation allocation that accords with principles of distributive justice.

Perhaps, a more fitting way to frame the point is to regard inter-nation equity, in its distributive sense, as operating at two co-linked layers of taxing rights apportionment. It is in the first layer that the entitlement of competing states to tax is established (by the presence of some form of economic allegiance of the taxable factor). Then there is the secondary layer where a state's obligation to give up taxing rights is more justly determined, not merely in accordance with some arbitrary "technical" principles, susceptible to political manipulation and unjust outcomes, but with due regard to *that* state's actual capacity to compromise. It is this second layer that produces

[73] *Ibid* at 83–84.
[74] See the discussion of "substantive reciprocity in chapter 2, section 2.3.3.4.

differentiated outcomes for different states. However, the differentiated levels of responsibility to give up taxing rights does not exterminate the fact that the poor state that gives up less of its taxing rights does have an underlying normative entitlement to tax. In other words, conformity with basic requirements of distributive justice should not be adjudged a displacement of the LIDC's inherent entitlement. So, it seems a mistake to portray the differentiated allocation of taxing rights as a form of redistribution (from rich to poor countries) that deviates from normative entitlement. It is only if the first layer does not exist that we can properly conceive inter-nation equity in the manner proposed by Ozai; and this would be the case in respect of special tax schemes that are designed to channel revenue to LIDCs that otherwise have no normative entitlement (sovereignty) to tax the particular base.

We may discern from the foregoing how the blurring between equity and charitable redistribution has the potential to undermine the potential for a more focused and serious consideration of bespoke tax policy initiatives that are deliberately designed to address "development goals".[75] It is important, for the purpose of conceptual distinction, to expend the resources of this chapter to explore the entailment of such initiatives.

As first example, albeit a somewhat obscure one, I reference U.S. author, David Pozen's claim about the existence in the U.S. tax system of collective measures that may be accurately characterized as "tax aid".[76] Pozen observes that:

> Since 1974, Congress has required the annual publication of a tax expenditure budget. Although not immediately evident from the budget data, in recent years a growing amount of expenditure has gone toward foreign aid. The reason lies in America's tax treatment of

[75] For instance, Gillian Brock, *Global Justice: A Cosmopolitan Account* (Oxford Scholarship Online, 2000) [proposing a global revenue mobilization initiative through various special tax regimes that are then channeled to the aid of poor peoples around the world]; Ayelet Shachar, *Birthright Lottery: Citizenship and Global Inequality* (Cambridge, Mass & London, England: Harvard University Press, 2009) [proposing a special "birthright privilege levy" on persons born into privileged societies to benefit those whom through sheer luck were born in poor countries].
[76] Pozen *supra* note 35.

> nonprofit organizations. Whenever U.S. charities and foundations spend money overseas - as they have increasingly been doing - some portion of this spending can be attributed to the support they receive from numerous state and federal tax privileges… Unlike traditional ODA, these tax expenditure funds are privately organized and distributed, yet unlike voluntary transfers they are paid for by the public fisc. This is not private aid; it is *privatized* aid.[77]

I can agree with Pozen that these tax expenditures conceptually constitute subsidies for U.S. aid agencies operating overseas and amount to indirect income transfers to recipients of aid in foreign countries.[78]

A more profound example is contained in a piece by American health law and policy scholar, John D Blum, which eminently experiments with the harmonization of taxation and global health policy.[79] Blum wrote at a time when the world was just emerging from a global health crisis, "the avian flu". Blum was conscious of the funding gaps for healthcare and development in LIDCs at the time and called for the initiation of a special international tax scheme – a sort of "moderate rate" "global corporate tax" on the world's most profitable TNCs – to generate revenue to address these gaps.[80] Blum considers two possible design approaches to the "global corporate tax." "One approach is to levy an annual tax on WTO members based on annual GNP, or to craft an assessment linked in some manner to the economic benefits derived from free trade."[81]

Blum picked TNCs as a tax base because, according to him, TNCs were great beneficiaries of the global trade system.[82] Fittingly, he also considered the World Trade Organization (WTO) the most suitable international organization to levy this tax, of course, with the consent of its members:

[77] *Ibid* at 643.
[78] For reasons stated above with respect to the Infanti opinion, I am less agreeable with Pozen that tax expenditures granted for-profit entities operating overseas also constitute tax aid.
[79] JD Blum, "Distributive Justice and Global Health: A Call for a Global Corporate Tax" (2007) 26:2 Med & L 203.
[80] *Ibid* at 207–211.
[81] *Ibid* at 209
[82] *Ibid* at 210–211.

> The World Trade Organization which sits at the apex of global economic interchange appears to be the most logical entity, outside the UN orbit, within which to explore the creation of legally based financial obligations. Specifically the WTO could become an entity charged not only with overseeing trade, but could take on the added task of channeling a portion of profits from trade into the financing of global human needs.[83]

Blum reasoned that his proposal, which, instructively, would draw largely from the tax base of non-beneficiary countries, had other benefits which include the fact that it would also enable the WTO to coordinate global health policy with the World Health Organization (WHO):

> Beyond opening up a new stream of funding for international health and development, a global tax run under the auspices of the WTO would become a vehicle to engage this global trading entity more directly in responding to the needs of poor nations and into coordination of efforts with global health bodies, such as the WHO.[84]

Blum's "global corporate tax" would be enforceable by the WTO under a special agreement that legally binds its members to report on the foreign corporations doing business in respective nations.[85] Therefore, "an enforcement mechanism to collect corporate tax revenue would need to be created most likely within the WTO nation in which a given corporation is doing business, and a global oversight and centralized collection system would need to be devised."[86]

For decades, scholars have discussed the prospects of introducing cross-border tax schemes that would compensate LIDCs for their consistent loss of human capital to HIDCs.[87] Building on this

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[83] *Ibid* at 208

[84] *Ibid* at 210

[85] *Ibid* at 209.

[86] *Ibid* at 209

[87] This idea, the so-called "Bhagwati tax proposal", is attributed to India-born American economist Jagdish Bhagwati. It was first discussed as part of a 1972 paper critiquing the foreign policies of the Nixon administration towards LIDCs. See Jagdish Bhagwati, "The United States in the Nixon Era: The End of Innocence" (1972) 101:4 Dedalus 25 at 44. Bhagwati's original thought was for the imposition of a tax, say, 15%, on the taxable earnings of immigrants, that would be collected by HIDCs and transferred to the LIDCs. The tax would be based on a moral obligation of HIDCs to provide assistance to LIDCs. Further iterations of the proposal include: Jagdish Bhagwati & William Dellalfar, "The Brain Drain and Income Taxation" (1973) I:1-2 World Dev 94; Jagdish Bhagwati & Martin Partington, eds, *Taxing the Brain Drain: A proposal,* vol 1 (Amsterdam: North-Holland, 1976); Jagdish N Bhagwati, ed, *The Brain Drain and Taxation: Theory and Empirical Analysis*, vol 2 (Amsterdam: North-Holland, 1976); Jagdish Bhagwati & John D Wilson, eds, *Income taxation and International Mobility* (Cambridge: MIT Press, 1989). The proposal has been the subject of much critique and reengineering. See JD Wilson, "Taxing the Brain Drain: A Reassessment of the Bhagwati Proposal", in E Dinopoulos, *et al,* eds, *Trade, Globalization and Poverty* (London: Routledge, 2007); John

body of scholarship, Yariv Brauner examines the potential use of taxation to generate development funds in connection with the immigration of skilled workers from LIDCs to HIDCs.[88] Some of the major obstacles to such a tax centre around *who* could impose it and how to administer it.[89] The original "Bhagwati tax proposal" contemplated a tax imposed by the host country while other iterations contemplated imposition by the sending country.[90] The idea of a host country imposed tax did not seem particularly feasible for various jurisdictional and tax policy reasons.[91] In contrast, the idea of the sending country imposing seemed appealing partly because it could be juxtaposed with a citizenship tax, which was already in existence at the time.[92] Brauner welcomed this similarity and sought to bridge the feasibility gap in the "Bhagwati tax proposal" by imposing the tax as a citizenship tax that is administrable as part of the international tax regime: that is, via the instrumentality of tax treaties. He quizzed rhetorically:

> Why, then, could such treaty partners not use a similar rule and the United States, the most important host country, allow it to happen (and even assist in collecting it, at least on behalf of its developing tax treaty partners)?[93]

Brauner's proposal requires the imposition of a new tax by sending/home countries who do not already impose a worldwide citizenship tax like the U.S. does.[94] However, the home country's tax system would continue to regard its overseas-based citizens as residents of the home country. In

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D Wilson, "A Voluntary Brain-drain Tax" (2008) 92 J Pub Econs 2385; John D Wilson, "Should Remittances be Taxed or Subsidized?" (2012) 19 Int'l Tax & Pub Fin 539; Domenico Scalera, "Skilled Immigration and Education Policies: Is There Still Scope for Bhagwati Tax" (2012) 80:4 The Manchester School 447; Speranta Dumitru, "Skilled Migration: Who Should Pay for What? A Critique of the Bhagwati Tax" (2012) 14:1 Diversities 9; Gillian Brock, "Debating Brain Drain: An Overview" (2016) 3:1 Moral Phil & Pol 7.

[88] Yariv Brauner, "Brain Draft Taxation as Development Policy" (2010) 55:1 St Louis U LJ 221.

[89] *Ibid.*

[90] *Ibid.*

[91] *Ibid* at 247–248.

[92] Michael S. Kirsch, "Taxing Citizens in a Global Economy" (2007) 82:2 NYU L Rev 443.

[93] Brauner *supra* note 88 at 249.

[94] *Ibid*.

other words, the tax operates as a tax on "residents" of the home country. Treaty provisions (tie-breaking rules) could then be made for double taxation relief.[95]

Similar to Blum's, Brauner's proposal has all the makings of international 'tax aid'. The distinctive component of the proposal is that the tax is imposed on a tax base that the LIDC would ordinarily not be entitled to tax, bearing in mind, especially, that administrative feasibility is integral to tax jurisdiction. Although the proposal defines the subjects of the tax as "residents" as a proxy term for citizens of the home country – to fit with conventional residence and source labelling patterns – the reality is that the proposal extends tax 'jurisdiction' beyond its conventional conceptualization by allowing an LIDC to tax income earned abroad by individuals that are also resident abroad.

A more recent case in point is the piece by Chatel & Li which aims to repurpose the OECD BEPS Pillar One Blueprint "from a taxing rights reallocation mechanism into an incremental global tax for sustainability". The authors pursue the ambitious project of linking taxation of TNCs to the global fight in achieving sustainable development, climate control and post-pandemic economic recovery. Their proposal would:

> repurpose Pillar One as described in the Blueprint from a mechanism of reallocating tax base under existing corporate income tax (CIT) to an incremental global tax on the largest and most profitable MNEs' market-based profit. As a new, standalone tax on MNEs – tentatively referred to as "Tax for Sustainability" – this proposed tax will define taxpayers and tax base in a way that is similar to those under the Blueprint, but will provide simpler computation and administration methods and, like a DST, will be separate from the existing CIT.[96]

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[95] Brauner expresses concerns that such a design could lead to tax planning by most skilled immigrants who will arrange their affairs to avoid normal residence taxation by the home country. He proposes various solutions to this anticipated problem, including altering the hierarchy of the tie-breaking rules to prioritize home country ties. For instance, he notes, "If the economic test does not produce the intended result, more weight could be given to family, social, and religious ties, as those ties tend to remain with the home country, while economic ties are often stronger with the host country". *Ibid* at 250.

[96] Sophie Chatel & Jinyan Li, "Repurposing Pillar One into an Incremental Global Tax for Sustainability: A Collective Response to a Global Crisis" (2021) 75::5 Bull Intl Taxn 1 at 3.

Under the proposal, a designated portion of in-scope (largest) TNCs' profits would be taxed by market jurisdictions (jurisdiction of sale of goods or services) and applied to finance common expenditures: the SDGs.

Because redistribution transfers revenue from HIDCs to LIDCs, a redistributive tax framework may include some form of accountability modalities that enable donor countries or stakeholders to track progress in the appropriation of the redistributed tax revenue by the recipient low-income country.[97] For instance, because of the spending imperatives contained in Chatel & Li's "Tax for Sustainability" proposal, there is an expectation that disposal of the tax revenue by governments would be subject to accountability measures. As the authors observe, "[a]ccountability by governments for public expenditure on SDGs and climate actions would thus be the counterbalance for levying the Tax for Sustainability on MNEs."[98] This seems to imply that governments that would not utilize the tax for the designated purpose have an obligation to not levy the tax. Such an exclusionary position is acceptable in so far as the proposal, as a whole, does not purport to displace the inherent rights that even a noncompliant country ordinarily enjoys to tax the same economic activities (tax base) situated within its borders. In other words, the special vehicle tax – or failure to comply with its accountability requirements – cannot purport to displace the underlying rights of a country to tax the income of TNCs (for in-country activities).

An explicit carve out of redistribution thought from inter-national tax equity would, therefore, help to eliminate ambiguities about whether countries can interfere with the fiscal appropriation policies of other countries. It is not unusual for donor countries to be undesirous of funnelling aid through state institutions in recipient countries but preferring instead to bypass them and invest in projects

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[97] Tracking progress does not only embed donor countries in implementation, but also puts the leaders of donor countries in a position to defend their redistributive policies before their domestic institutions of responsibility.

[98] *Ibid* at 13.

either directly or through humanitarian agencies.[99] International tax redistribution, it must be said, contemplates donor countries having a say in how recipient countries appropriate tax revenue. The purpose may be to avoid "mismanagement" or "misappropriation" of "tax aid". In contrast, international tax equity does not erode fiscal sovereignty, which means that if a country taxes income that it is normatively entitled to tax, no other country can purport to impose or imply spending imperatives or some duty to account. A presence – or lack – of responsible government to administer tax revenue would not be a material consideration.[100] Without a proper carveout of international tax redistribution from equity thought we risk inducing a perception that HIDCs can superintend how LIDCs appropriate their own tax revenue.

A telling attribute of Chatel & Li's "Tax for Sustainability" proposal is that it does not *ab initio* present itself as a device for equitable distribution of taxing rights between countries, but instead reads as a bespoke tax scheme (separate from the corporate tax and withholding tax) to harness resources for the specific purpose of confronting common global challenges like climate change and sustainable development.[101] Some bit of confusion does set in from the incorporation of various attributes that one would expect to see in a regular tax compromise. Of specific attention is the contention that the distributional scheme contemplated under the proposal would foster equitable taxing rights distribution:

> Furthermore, in order to address the issue of inter-nation inequalities in fiscal capacity, our proposal could have a redistributive mechanism built in so that low-income countries could tax their share of the global profit at a higher rate. Such mechanism is unprecedented and

[99] See Falcão "Inter-nation Equity" *supra* note 54.

[100] The concerns expressed by Stark and Rosenzweig respectively about handing more revenue to corrupt governments would only be relevant in Chatel & Li's proposal if the "recipient" states do not have an inherent competence to tax but are gifted that privilege by some charitable redistributive international consensus.

[101] The three envisaged beneficiaries of this tax scheme would be governments, TNCs, and our planet.

> feasible only through a multilateral tax instrument such as our proposed tax. <u>It would assist developing countries in meeting their sustainable development goals</u>.[102]

The broad policy reach of the Tax for Sustainability proposal raises questions as to whether it is merely intended to be a special purpose tax scheme or a more formal mechanism for taxing rights allocation between states that are, in principle, entitled to tax the base. The ambiguity is aggravated by the fact that the proposal is primed to operate as a substitute to a formal taxing rights allocation proposal being considered at the time by states. If the authors' proposal is indeed to cover the same tax base as the OECD project, then, in my view, it cannot presume to impose spending imperatives on states exercising their inherent taxing rights.[103]

To elaborate on the base concern, I lean on Ross P Buckley's classic redistributive piece, "Introducing a 0.05% Financial Transactions Tax as an Instrument of Global Justice and Market Efficiency".[104] As the title implies, the author advocates the imposition of a global financial transactions tax on "wholesale capital market transactions" to raise revenues of up to $500 billion per annum to help poor countries achieve various aspects of the now-superseded Millennium Development Goals.[105] The distinctive feature of this proposal is that the tax would be imposed on a base that extends far beyond what LIDCs are themselves entitled to tax. Instead, the proposal would require HIDCs to impose the tax on transactions that occur within their own borders, and, therefore, entirely within their own base.[106]

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[102] *Ibid* at 14.
[103] Also, while compromises can be made between countries, low-income countries should, in principle, not require the permission of other countries to exercise the right to tax *their* share of the "global profit" at a higher rate, if they only tax profits from economic activities that occur within their borders.
[104] Also, Blum *supra* note 79.
[105] Ross P Buckley, "Introducing a 0.05% Financial Transactions Tax as an Instrument of Global Justice and Market Efficiency" (2014) 4 Asian J Int'l L 153.
[106] *Ibid* at 158.

It can be no more straightforward. This is the true sense of redistribution (in so far as the term connotes wealth transfers from HIDCs to LIDCs). It does not, in my view, amount to redistribution to "allow" poorer countries to tax at a lower threshold or higher rate, for instance, a base that they are ordinarily entitled to tax, based on the normative principles of tax jurisdiction (discussed in chapter 2) especially when their extant inability to tax the base is the consequence of artificial restrictions stipulated by the subsisting framework.

It is, therefore, an open question whether the Tax for Sustainability proposal can truly be regarded as a special purpose tax scheme to mobilize revenue towards actualization of the SDGs or, on the other hand, as a regular international tax compromise that aims to allocate taxing rights between countries. The problem with the proposal being a hybrid of both perspectives is the blur that ensues – the absence of foundational clarity between equity (entitlement) and redistribution (charity).

The failure to effectively distill international tax redistribution thought from equity thought fosters superfluous debates about whether there is a cosmopolitan duty to change the distributional rules in international tax.[107] By focusing on entitlement theory, inter-national tax equity can provide a more focused framework for critical diagnostics of inherent flaws in the tax norms. Findings from such diagnostics then become the trigger for the pursuit of normative reform. Conversely, hinging the reform of flawed international tax norms on humanitarian programs that are part of the SDGs can obfuscate the fact that even without such programs there are inherent distributional flaws in

[107] See Ilan Benshalom, "The New Poor at Our Gates: Global Justice Implications for International Trade and Tax Law" (2010) 85:1 NYU L Rev 1; Tsilly Dagan, "International Tax and Global Justice" (2017) 18:1 Theoretical Inquiries in L 1; Stewart *supra* note 42; Laurens van Apeldoorn, "Exploitation, International Taxation, and Global Justice" (2019) 77:2 Rev Social Econ 163; Peter Hongler *Justice in International Tax Law: A Normative Review of the International Tax Regime* (Amsterdam: IBFD: 2019); Stark *supra* note 63; Broekhuijsen & Vording *supra* note 21; Ivan Ozai, "Origin and Differentiation in International Income Allocation" (2021) 44:1 Dal LJ 129.

the system that ought to be redressed.[108] If a structure is innately flawed, we should not need an external reason to fix it.

In any case, a distinction of redistribution from entitlement enables us to undertake a more explicit consideration of whether the tax system is the more efficient mechanism to deliver subsidies to LIDCs. It allows a careful and, perhaps, empirical consideration of the adequacy and efficiency of the redistributive programs delivered through the tax system design vis-à-vis programs delivered through more conventional ODA. We can assess whether tax policymakers are best equipped to design redistributive schemes or whether such responsibility should be placed in different hands: aid agencies, for instance.[109]

1.3 Chapter Conclusion

The idea of equity in international tax discourse has been deployed broadly. This broad deployment makes it difficult to tell, in some cases, whether what is being discussed is equitable allocation of taxing rights between countries whose tax jurisdiction intersect or some charitable redistribution of tax aid from rich to poor countries. There is need for some reimagination of the scope of the equity factor in international tax, in my view from a perspective that places tax sovereignty or fiscal self-determination at the centre of the discourse. Such a reimagined perspective would displace the notion that greater allocation of taxing rights to LIDCs is a gesture of charity (or tax aid) and render more distinct those situations where countries do utilize their tax systems – or the

[108] Pillar One of the OECD BEPS project, for instance, represents an attempt by most HIDCs to address distributional flaws in the existing norms – namely, the inadequacies of the traditional PE concept – that, in their view, unfairly restricts their right to tax revenue outflows from their borders. It is worth pondering, why does no one portray this initiative as a scheme for charitable redistribution from the U.S. (the home country of the most profitable beneficiaries of the current system) to other HIDCs? Why does that narrative only seem to apply to LIDCs?
[109] Some scholars have craved the active involvement of NGOs in the international tax reform scene to enhance the legitimacy of the existing framework. It is worth considering whether NGOs that are active coordinators of developmental aid delivery are also placed to develop such schemes in a way that tax policy experts may not be able to. See Cees Peters, "Global Tax Justice: Who's Involved?" in R F van Brederode, ed, *Ethics and Taxation* (Singapore: Springer, 2020) 165 at 168 and 179

international tax regime – as a vehicle for revenue transfer to LIDCs. The core focus of such a perspective is the relaxation or eradication of artificial barriers in the international tax regime that get in the way of origin-based revenue mobilization for LIDCs. It is this thought that I discuss as "reasonable impairment compromise" in the next chapter.

Chapter 2: Reasonable Impairment Compromise (RIC)

> "*Asking you to give me equal rights implies that they are yours to give. Instead, I must demand that you stop trying to deny me the rights all people deserve*" – Elizabeth Peratrovich.

2.1 Overview

This chapter develops a framework for the evaluation of fairness in the allocation of taxing rights between states, with particular regard to compromises involving LIDCs. In a nutshell, the idea of reasonable impairment compromise (RIC) is that sovereign states have an inherent entitlement (jurisdiction) to tax income that emanates from their territory and that only an international tax compromise that does not unreasonably impair that inherent jurisdiction can be adjudged fair. The need for states to coordinate their tax rules to facilitate international trade and wealth creation lies at the heart of international tax compromise. However, regardless of this justification, the impairment that derives from tax compromise must be reasonable. On the standard of reasonableness, I argue that we must take into cognizance a totality of factors – mainly fiscal – that concern states and the real impact that any impairment may foist on individual states' inherent tax jurisdiction. If an international tax compromise excessively impairs the taxing rights of a state it may be deemed unreasonable, therefore, inequitable.

I open this chapter with a brief explanation of the point that RIC proposes to reclaim or reinfuse the fiscal self-determination of LIDCs in the inter-nation equity conversation. Then I move into the RIC test proper. Here, I discuss the theoretical factors that underpin a state's tax jurisdiction. I follow this up with a discussion of the idea of tax compromise by delving into an examination of the dominant model of compromise in the international tax regime: the OECD Model Tax Convention on the Taxation of Incomes and Capital (OECD MTC). I have chosen this model not because it reflects everything that countries do, both in their tax treaties and domestic legislation,

but because it constitutes the basic structure of the international double taxation regime. It would be impossible to go through the practices of individual countries one-by-one, but it is certainly helpful to have a basic common structure that can be referenced. I also consider in that choice the dominant role that the OECD played and continues to play in the framing of international tax norms. This continues to be evident in the design of the international tax compromise that I discuss in chapter 3. In any case, putting the OECD MTC at the center of analysis provides me a target that I can subsequently use, in contrast with other models, to demonstrate how a compromise can be “more reasonably” restrictive of tax jurisdiction. The rest of this chapter is dedicated to discussing the reasonableness component in the RIC test. Here, I briefly discuss some of the factors that I consider helpful in determining whether it makes sense for a state to compromise its original or inherent tax jurisdiction.

2.2 Fiscal Self-Determination as the Centerpiece of RIC

Let me begin by reiterating the point that the international tax regime is designed to limit the exercise of sovereign tax jurisdiction, and it does so by extracting the surrender of taxing rights aimed at, historically, constraining the burdens of international double taxation. For a century, countries have “willingly" surrendered their inherent tax jurisdiction on this premise. However, the international tax regime remains perennially shrouded in a trilemma of tax sovereignty, double taxation, and tax competition.[110] The high degree of multilateral engagement on international tax

[110] Philipp Genschel & Thomas Rixen, “Settling and Unsettling the Transnational Legal Order of International Taxation”, in TC Halliday & G Shaffer, eds, *Transnational Legal Orders* (2015: Cambridge University Press) 154 at 156 [“national tax sovereignty, that is, the exclusive right of national governments to make tax law (legal sovereignty), to administer and enforce tax law (administrative sovereignty), and to claim all tax revenue for the national budget (revenue sovereignty). Tax sovereignty is a cause of international double taxation, because it empowers national governments to decide independently whether and to what extent cross-border activities are liable to domestic tax.”]. The concept of “fiscal self-determination” connotes a state’s effective sovereignty in fiscal matters. Effective (or *de facto*) sovereignty, according to van Apeldoorn, refers to the ability of a state to achieve policy goals by means of legislation and is distinguished from formal (or *de jure*) sovereignty consisting in the right to write and enforce law. See Laurens van Apeldoorn, “BEPS, Tax Sovereignty and Global Justice” (2018) 21:4 Critical Rev of Int’l Social &

matters demonstrates states' recognition of the importance of continued coordination of their sovereign tax policies – by narrowing their exercise of tax jurisdiction – so that cross-border economic activities do not become inundated by tax burdens and uncertainties. However, the slew of unilateral digital tax measures that has emerged in recent years, perhaps more than anything else, also reflects states' conflicting desire to reassert their tax jurisdiction and fiscal self-determination, even if that assertive stance entails departure from the conventional constraints of the extant regime – in other words, a reprioritization of the tax sovereignty component of the international tax trilemma. This aspiration holds true for HIDCs and LIDCs alike. Countries' attempts to forge a multilateral compromise of taxing rights, amidst their unilateral leanings, makes it as pertinent as ever to reimagine and reincorporate the equity element into any compromise, i.e., in a way that better reflects their leanings towards tax sovereignty and fiscal self-determination; and, this time, more than in the past, the peculiar taxing rights (preservation) claims of LIDCs must feature prominently. Such a framework should conceptualize inter-nation equity as, fundamentally, a question of "how much taxing rights should a country be expected to give up" rather than "how much taxing rights or revenue a country should receive". It is by framing the issue in this entitlement image that we can do justice to the case of LIDCs.

RIC does not evolve on a premise that HIDCs ought to redistribute *their* tax revenue to LIDCs. That would be charity. Rather, it advocates the insulation of the tax base of LIDCs from "unreasonable" artificial restriction. Essentially, what LIDCs really need from the international tax regime is not to redistribute tax aid from HIDCs to LIDCs but rather to prescribe an allocational framework/formula that does not unreasonably fetter the autonomy of LIDCs to exploit their tax

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Pol Phil 478 at 479; Peter Dietsch, "Rethinking Sovereignty in International Fiscal Policy" (2011) 37:5 Rev Int'l Stud 2107–2120

base as they deem necessary for their own fiscal aspirations. In that sense, therefore, the RIC framework, approaches allocational issues in a way that seeks to preserve the tax sovereignty and fiscal self-determination of LIDCs.

2.3 The RIC Test

Application of the RIC concept requires a trifactor analysis of any international tax compromise that apportions taxing rights between states. Through such analysis we can ascertain whether a compromise can be deemed reasonable – and therefore equitable – to the states involved. The three questions constituting this test are: first, whether there is a normative basis for a state to tax; second, whether a compromise impairs tax jurisdiction; and third, whether the impairment is reasonable in the circumstances. The test is progressive, which means that we move from stage to stage and can stop at any stage of the analysis if we deem the outcome to be in the negative. For instance, if it is concluded that there is no basis to tax, the analysis ends there. If we conclude that the state has a basis to tax, we can then proceed to the next step, and so on.[111]

2.3.1 Is there a Legitimate Basis to Tax? (Theories of Tax Jurisdiction)

The first step in the trifactor analysis of RIC is to ascertain whether there is some legitimate basis to tax income. Once there is such a basis then tax jurisdiction (exclusive or concurrent) inheres in a state. There is no attempt to reinvent the will here. Instead, the approach is simply to reaffirm the established theoretical norms of international tax law that underpin a state's entitlement to exercise tax jurisdiction. Although there are various such theories – and a few of them are examined here – I zero in on the theory of economic allegiance, which is the dominant view.

[111] I should state here that if there is no conceptual basis to exercise tax jurisdiction it is unlikely that countries would come together to form a compromise. It follows the common logic "ex nihilo nihil fit". Instead, there might be a situation where, as we demonstrate in chapter one, a special tax scheme is designed to channel aid to LIDCs. In that case, what we have is not a compromise *per se* but a developmental aid scheme that is fostered through taxation.

A state's competence to tax is an amalgam of economic, political, and administrative realities. International fiscal law, the projection of general international law in matters of taxation,[112] customarily recognizes the right to tax as an aspect of sovereignty.[113] Various theories have been propounded to justify a sovereign state's jurisdiction to tax. They include: (1) the realistic theory, which equates jurisdiction to a state's capacity to exercise physical power over the subject of taxation; (2) the contractual theory, which regards taxation as a contractual payment made by the subject in exchange for services provided by the state; (3) the ethical theory, which asserts that taxation is a return for benefits or advantages received from the state; and (4) the sovereign theory, which regards tax jurisdiction as an element of sovereignty – by reason of which any person that owes (economic) allegiance to a state is obligated to contribute to the preservation of that state. Below, I briefly explain each of these theories.

2.3.1.1 Realistic Theory

The view held by realistic theorists like Stimson is that jurisdiction is equivalent to physical power.[114] According to Stimson:

> The fundamental principle of jurisdiction is simple enough. Jurisdiction is physical power. A sovereign State has no physical power over persons and property outside its territory.[115]

According to Dutch legal scholar Rutsel Martha, the realistic position implies that wherever an entity can or actually exercises physical power it has jurisdiction as a matter of law, including jurisdiction to tax.[116] Criticism of the theory, therefore, follows its excessive emphasis on physical

[112] Rutsel Silvestre J Martha, *The Jurisdiction to Tax in International Law: Theory and Practice of Legislative Fiscal Jurisdiction* (Deventer, The Netherlands: Kluwer Law and Taxation Publishers, 1989) at 2.
[113] A R Albrecht, "The Taxation of Aliens under International Law" (1952) 29 Brit YB Int'l L 145; Alfred Nizamiev, "The Main Characteristics of State's Jurisdiction to Tax in International Dimension," (LLM Dissertation, University of Georgia, 2003) at 5.
[114] E Simpson, *Jurisdiction & Power to Tax* (1933) 111, cited in Martha *supra* note 112 at 19.
[115] Martha *supra* note 112.
[116] *Ibid.*

power.[117] The theory has been dismissed on account of its lack of reality, considering, as Martha observes, that states do exercise physical power (sometimes even in defiance of the law) outside their territory without therefore gaining a right to tax; and considering that states have long prescribed taxes even where they have no physical power.[118] A contrary and, perhaps, more realistic view is expressed by Beale to the effect that the creation of legal right is an act of law; and the power of a sovereign, therefore, to affect legal rights, depends upon the law, which is the source of all sovereign jurisdiction.[119]

Even if the realistic theory were initially defensible, its continued defensibility in the context of modern realities is questionable because the theory would effectively rob a state of jurisdiction to tax persons and property outside its physical borders even though the state has provided the enabling environment for the taxpayer to earn taxable income.[120]

2.3.1.2 Contractual Theory

The contractual theory regards taxation as a presumptive *quid pro quo* arrangement between the state and the taxpayer. It advances the view that taxation is the payment for goods and services received from the taxing state[121] on the basis of a (presumed) contract between the holder of fiscal jurisdiction and the fiscal subject.[122] In its more moderate and, perhaps, conventional sense, the theory affirms that the right to tax is essentially a contractual one, albeit not entirely subject to the

[117] *Ibid.*
[118] *Ibid.*
[119] Joseph H Beale, "Jurisdiction to Tax" (1919) 32:6 Harvard L Rev 587.
[120] The realist theory does contribute meaningful insight to the question of administrative feasibility as a component of tax competence. A state cannot be said to possess tax competence if its jurisdiction to tax is effectively constrained by its capacity to assert jurisdiction over the subject (person) or object (activity) of taxation. However, literal application of the theory misses the mark on this point in the sense that it would equate administrative feasibility with physical presence or control.
[121] Albrecht, *supra* note 113 at 145–146.
[122] Martha *supra* note 122 at 21.

same rules that govern ordinary contracts.[123] Going by this theory, states' entitlement to tax entails a tacit bargain to provide goods and services to the taxpayer. This would mean that legitimacy to tax derives from an agreed and concomitant provision of goods and services to the taxpayer.

A basic flaw of the contractual theory, it has been argued, is the absence of a key ingredient of a valid contract: consensus. Taxes are, by nature, imposed, not "agreed".[124] The non-consensual nature of taxation is thus at variance with the doctrine of freedom of contract.[125] Indeed, as far as tax obligations are formed, there is nothing comparable with a bargain between the parties as to the terms of the 'contract': how much the taxpayer must pay and how much the taxpayer must receive in return. The terms are variable at the will of the state, which may alter or abolish existing taxes and introduce new ones, spending the proceeds as it deems fit without any obligation to consult the foreign taxpayer.[126]

A.R. Albrecht does identify two instances where contractual relations can affect or (re)define a state's right to tax: (1) when the state enters into a binding and mutually advantageous agreement with a taxpayer that sets out the nature and amount of taxation (e.g., a binding advance pricing agreement); and (2) when two or more states have concluded a tax treaty, say for the avoidance of double taxation, discrimination or for the conferment of special privileges. Although such a treaty does not create or impose tax, it restricts it.[127]

[123] Albrecht *supra* note 113 at 146.
[124] *Ibid.*
[125] Martha *supra* note 112 at 21.
[126] Albrecht *supra* note 113 at 146. It is arguable that the presence of a taxpayer within a state's jurisdictional reach implies agreement with the terms of the "contract". Otherwise, a taxpayer who is disagreeable with their taxation – and of course has the capacity of mobility – would relocate themselves or their assets from the state.
[127] *Ibid* at 146–147.

2.3.1.3 The Ethical Theory

The 'ethical' or retributive theory – also called the 'benefits' theory – regards taxation as a return for benefits or advantages derived from the state.[128] Martha identifies the silent normative underpinning of this theory as: he who belongs to – or rather benefits from –an economic community has an ethical duty to pay taxes to that community.[129] It has been noted that the fundamental justification for a government levying taxes on their community members is the services provided by the government to community members, and that this is inherent in the concept of responsible government.[130]

As a norm that is deemed to derive from 'metajuristics' ('justness') rather than 'pure juristics' ('legal thought'), the weakness of this theory, it has been argued, lies in that "no objective parameters of 'just' can be said to exist, and, therefore, attempts to formulate them often result in metaphysical speculation".[131] Also, in reality, it might be difficult to attain a matching correlation between taxes paid and benefits received. Those who pay more may not necessarily receive more from the state, and vice versa. This criticism, however, suggests that the benefits theory is more aspirational than precise in its manifestation.

2.3.1.4 Sovereignty Theory

There is a generally accepted principle in international law that taxation is a justifiable "attribute of statehood or sovereignty, limited by international law, and exercised in varying manner

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[128] *Ibid* at 146.
[129] Martha *supra* note 112 at 20
[130] Peter Harris & David Oliver, *International Commercial Tax* (Cambridge, UK: Cambridge University Press, 2010) at 43.
[131] Albrecht *supra* note 113 at 148.

according to the policies of the states possessed of it".[132] In other words, taxation is an exercise of jurisdiction, and jurisdiction is an exercise of sovereignty.[133]

According to the American law scholar Joseph Beale:

> The power to tax is one of the attributes of sovereignty; and the jurisdiction to exercise the power is coterminous with the bounds of the sovereign's jurisdiction. "It is obvious that it is an incident of sovereignty, and is coextensive with that to which it is an incident. All subjects over which the sovereign power of a state extends are objects of taxation, but those over which it does not extend are, upon the soundest principles, exempt from taxation.... The sovereignty of a state extends to everything which exists by its own authority or is introduced by its permission…. The power to tax involves the power to destroy." "The power of taxation, however vast in its character and searching in its extent, is necessarily limited to subjects within the jurisdiction of the state. These subjects are persons, property and business.[134]

The French scholar Allix traces a state's derivation of the right to tax to the historical development of the state concept. He notes that the primary right, as well as the primary obligation of the state is to secure its own existence. Accordingly, the state enjoys the right to demand the necessary means from those subject to its laws.[135]

The original conception of sovereignty, as a political concept, entails that only those who owe political allegiance to a state are subject to its jurisdiction and, therefore, taxable by it. This was problematic in the context of taxing foreigners especially in the face of rapid cross-border interactions of individuals and economic activities.[136] Does the fact that foreigners do not recognize the sovereign authority of a foreign state negate the jurisdiction of states to tax persons other than their nationals? Albrecht observes emphatically that the sovereignty theory is not

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[132] See Albrecht *ibid* at 148.
[133] Martha *supra* note 112 at 22.
[134] Beale *supra* note 119 at 587 (quoting "Marshall, C.J., in M'Culloch v. Maryland, 4 Wheat. (U. S.) 3i6, 4", and "Field, J., in State Tax on Foreign-Held Bonds, I5 Wall. (U. S.) 300 (1872)").
[135] Allix, *La Condition des Etrangers au Point de Vue Fiscal,* 61 RdC 541 at 550, cited in Martha *supra* note 112 at 22.
[136] Martha *supra* note 112 at 22.

nullified by the fact that foreigners do not recognize the foreign taxing state as their own sovereign, for while they cannot for this reason be compelled to pay taxes to it on the ground of political allegiance, they may nevertheless become subject to taxation by virtue of the territorial sovereignty of the foreign power whenever they, their property, or their economic activity may be located within its jurisdiction.[137] This jurisdictional evolution is justified on the foundation that a state is more than political, and has both social and economic dimensions.[138] The now well established concept of "economic allegiance" is the embodiment of this thought, and explains the duty of foreigners or non-residents to pay taxes to a state because of their presence, their possession of property, or economic activity within its borders.[139]

Of the theories discussed here, the sovereignty theory appears to be the most plausible and defensible justification for tax jurisdiction.[140] Although the dynamics of global economic integration and capital mobility tremendously challenge the exercise of tax sovereignty,[141] the underlying legal theory of sovereignty remains a most valid and most universally accepted basis for the assertion of jurisdiction. It is worth highlighting, however, that although sovereignty comprises both political and economic allegiance, the latter continues to define international tax jurisdiction.[142] I am, therefore, in concurrence with the settled notion that *a* justifiable basis for the exercise of tax sovereignty is the existence of economic allegiance by the taxpayer to the

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[137] Albrecht *supra* note 113 at 149.
[138] Allix *supra* note 135 at 553, cited in Martha *supra* note 112 at 22.
[139] Albrecht *supra* note 113 at 149.
[140] For a similar view, see Martha *supra* note 112 at 23.
[141] Lucas Bretschger & Frank Hettich, "Globalisation, Capital Mobility and Tax Competition: Theory and Evidence for OECD Countries" (2002) 18:4 European J Pol Econ 695 [finding that increased globalization forces national governments to lower corporate taxes]; Emblad *supra* note 15 at 4 ["I try to show how sovereignty to tax is increasingly being constrained by the mobility of private resources, or at least by convictions about their mobility. This development has incited tax competition in-between states and deprived developing states (primarily) of much needed revenue"].
[142] Jinyan Li, Nathan Jin Bao, & Huaning (Christina) Li, "Value Creation: A Constant Principle in a Changing World of International Taxation" (2019) 67:4 CTJ 1107.

state. This conversation, therefore, proceeds on the track of economic allegiance, the dominant theory of tax jurisdiction.

The doctrine of economic allegiance suggests that a government has jurisdiction to tax when there is a sufficient connecting factor between the taxpayer and the state, i.e., a recognized basis of economic allegiance.[143] In other words, a taxpayer's economic allegiance lies to the state where the true economic interests of the taxpayer are.[144] To ascertain such interests, consideration must be given to the acquisition of wealth, the location of wealth, the enforceability of the right to wealth, and residence or domicile.[145] Taxing wealth on the basis of economic allegiance is partly justified on the notion that the taxing state(s) provides the conditions suitable for the acquisition, protection, and enjoyment of that wealth.[146] In that sense, the doctrine incorporates the view that those who benefit from government services are obliged to fund the government.[147]

Distinction is often made between a tax that is imposed on a person and a tax that is imposed on an activity or thing (*in rem*). In the context of international taxation, while the personal tax requires some connection between the person and the taxing state, the *in rem* tax requires connection between the activity or property and the taxing state.[148] The income tax focuses on the activity or thing from which the income derives, as well as the person deriving income.[149]

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[143] Harris & Oliver *supra* note 130 at 43.
[144] Professors Bruins, Einaudi, Seligman, and Sir Josiah Stamp, *Report on Double Taxation, Submitted to the Financial Committee* (League of Nations Doc. No. B.F.S. 73.F.19, 40, 1923) [hereinafter the 1923 Report].
[145] Ke Chin Wang, "International Double Taxation of Income: Relief through International Agreement 1921–1945" (1945) 59:1 Harv L Rev Assoc 73 at 82.
[146] See 1923 Report *supra* note 144 at 20. See Jinyan Li, Arthur J Cockfield & Scott Wilkie, *International Taxation in Canada: Principles and Practices* (Toronto: 4th ed, Lexis Nexis, 2018) at 23–25.
[147] Harris & Oliver *supra* note 130 at 43
[148] *Ibid* at 46.
[149] *Ibid.*

2.3.1.5 Economic Allegiance of the Person (Residence-based Taxation)

It is common for states to exercise jurisdiction to impose income tax on persons who are deemed to have a sufficient connection with them. As previously stated, a person may be connected to a state in various ways, including their presence, or residence within that state or, more politically, their citizenship or nationality of that state. These forms of connection are deemed to have varying degrees of substance and formality.[150] However, "residence" is widely accepted as an appropriate connection justifying the imposition of income tax on the person.[151] According to Harris & Oliver, residence is neither 'too fleeting', as 'mere presence' may be, nor 'too formal', as citizenship may be.[152] A person may be a citizen of a country and yet be resident elsewhere, while a person that is present in a country may not receive any substantial government services from that country.[153] The United States is a rare example of states that impose taxes on the basis of citizenship.[154] Another example is Eritrea, which imposes a 2% 'diaspora tax' on its citizens.[155]

To further my articulation of the first branch of the RIC test, I focus on "residence", the most widely accepted connecting factor entitling a state to tax a person – one that is entrenched in both domestic tax law and tax treaties.[156] "Residence" describes the measure of personal connection or adherence that a "person" (taxpayer) has to a tax jurisdiction.[157] The term "person" refers to a natural person (an individual) or a legal person (an artificial person). While there is no serious

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[150] Harris & Oliver *supra* note 130 at 42–43.
[151] *Ibid* at 43.
[152] *Ibid.*
[153] *Ibid.*
[154] For some critical review of the U.S. citizenship-based tax regime, see Ruth Mason, "Citizen Taxation" (2016) 89:2 Southern Cal L Rev 169; Allison Christians, "A Global Perspective on Citizenship-Based Taxation" (2017) 38: Mich J Int'l L 193.
[155] See Kirsch *supra* note 92; Peter J. Spiro, "Citizenship Overreach" (2017) 38:2 Mich J Int'l L 167
[156] See, for instance, Article 1 of the OECD Model Tax Convention: ["This Convention shall apply to persons who are residents of one or both of the Contracting States"]; subsection 2(1) Canada Income Tax Act: ["An income tax shall be paid, as required by this Act, on the taxable income for each taxation year of every person resident in Canada at any time in each year"].
[157] Li, Cockfield, & Wilkie *supra* note 146 at 26–27.

debate as to the character of the natural person, there are various forms of entities that may constitute artificial persons, and this plurality can be consequential for tax purposes. Common forms of artificial persons are corporations, partnerships, limited liability partnerships and trusts. An entity that is not recognized as a person (whether for general law or tax law purposes) is said to be transparent, i.e., the law looks through it to see who the persons behind it are and it is those persons who are charged to tax.[158] While corporations typically enjoy a separate legal existence from their members, even for tax purposes, some artificial entities may be regarded as either transparent or possessing a distinct legal identity. This characterization applies for either general (corporate) law or tax purposes.

The question of whether an entity meets the requirement of a 'person' is generally determined by domestic law. Each country's domestic tax law specifies which entities are considered "persons" for tax purposes. Usually, domestic tax law either adopts the general law definition of legal personality (e.g., corporate law) or stipulates its own peculiar definition.[159]

Sometimes, domestic law also deals with the characterization of entities organized under foreign law. This can result in situations where a person characterized as a separate legal entity under the laws of one country is concurrently treated as transparent (i.e., not a corporation, but a mere branch or partnership) under another country's laws.[160]

It is also within the purview of domestic law to determine whether 'separate legal entities' in a corporate group (such as subsidiaries) should be taxed separately or as a unit. In most countries,

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[158] Harris & Oliver *supra* note 130.
[159] *Ibid.*
[160] *Ibid.* Avi-Yonah *supra* note 2 at 34–35.

domestic tax law follows general (corporate) law in mostly regarding subsidiaries as tax subjects separate from their parent corporation.[161]

After identifying the subject of taxation (the person) the next determination to be made is whether the person is 'resident' in the state seeking to tax their income. The domestic law of each state stipulates the criteria for determining what it means to be resident in that state, although such domestic stipulations are usually streamlined by internationally accepted norms. Countries adopt different tests for determining whether a person is resident in their territory.[162] The nature of the person – whether natural or artificial – impacts the applicable test.[163] For individuals, there are two main ways of determining residence: according to the time spent in a particular country or according to the degree of connection that the person has to that country.[164] With regard to the latter, most tests focus on the maintenance of a dwelling or abode in the particular country,[165] while factors, like family and social ties, location of income-producing activities, bank accounts, citizenship, domicile, right to stay (e.g. visa status) and a prolonged physical presence in a country may also come into play.[166] Ultimately, facts are extremely important in any such determination.[167]

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[161] Harris & Oliver *supra* note 130. Article 3(1) of the OECD Model Convention 2017 simply defines the term "person" to include 'an individual, a company and any other body of persons'. Para 3(1)(b) further states that the term 'company' means anybody corporate or any entity that is treated as a body corporate for tax purposes. The Convention allows reference to the domestic law of each state party when there is need to define a term. The main exception is when the term is already defined in the treaty. Suffice it to state that unless specific countries utilizing the model opt to create a common definition there could be conflicting definitions of 'persons' between treaty partners.

[162] Harris & Oliver *supra* note 130.

[163] *Ibid*

[164] Lynne Oats, Angharad Miller & Emer Mulligan, *Principles of International Taxation* (Hayward's Heath & London: Bloomsbury Professional, 2017) at 49 (observing that the number of days of physical presence in a country is used by several jurisdictions to determine the residence of an individual taxpayer).

[165] Harris & Oliver *supra* note 130.

[166] *Ibid.*

[167] Canada's Income Tax Act (ITA) declares that tax is payable on the income of 'any person' resident in Canada 'at any time in the year'. See subsection 2(1) ITA. The ITA stipulates two forms of "resident" for an individual: a "deemed resident" or an "ordinary resident". Generally, a deemed resident is a person who spends a period of or combined period of 183 days or more in Canada in a relevant year of assessment. See ITA, para 250(1)(a). Subsection 250(3) merely states that "reference to a person resident in Canada includes as person who at the relevant time ordinarily resident in Canada". Canada's tax authority fills the statutory gaps by taking the factual approach to determining whether an individual is resident in Canada. See Income Tax Folio S5-F1-C1, para 1.8 ["To determine residence

The determination of corporate residency has its peculiarities. Basically, it involves two approaches: the legal approach and the economic approach.[168] The legal approach regards the country of incorporation or registration as the country of residence, while the economic approach regards the place of management or the principal business location of the entity as its residence.[169] Both approaches attract varying practical challenges. For instance, the economic test may be difficult to apply particularly in the era of electronic communication, and it may not be clear where such management decisions are made or they may be made in a number of places simultaneously.[170] The legal test is also susceptible to manipulation because of the capacity of corporations to register their businesses outside the countries where they operate, for sheer tax avoidance purposes.[171] Countries may use either test or a combination of both tests.[172]

To sum it up, there are a few recognizable connecting factors that justify a state's jurisdiction to tax the income of a person. Principal among them, in the eyes of international tax law, is residence. International tax law recognizes the jurisdiction of a state to tax the income of a person who is resident there, whether the taxpayer is a natural person or artificial entity. Residence is generally

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status, all of the relevant facts in each case must be considered, including residential ties with Canada and length of time, object, intention and continuity with respect to stays in Canada and abroad"]. For a consideration of residence tests used by several other countries (Germany, India, Japan, and the United States), see Oats, Muller & Mulligan *supra* note 164 at 52–55.

[168] Oats, Muller & Mulligan *supra* note 164 at 77.

[169] *Ibid.* Article 4(1) of the OECD MTC provides that "the term 'resident of a Contracting State' means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature…" An obvious exclusion from this definition, however, would be any person that is liable to tax in that State in respect only of income from sources in that State.

[170] Harris & Oliver *supra* note 130.

[171] Oats, Muller & Mulligan *supra* note 164 at 86.

[172] Countries that use the legal test include China, Japan, Russia, and the United States. China and Australia also use the management and control test for companies incorporated overseas. Most commonwealth countries emulate the UK in using the management and control test, sometimes supplemented by an incorporation test. See generally, Oats, Muller & Mulligan *supra* note 164 at 86–88.

defined under domestic law. Where a person is a resident of more than one state, each of those states has jurisdiction to tax the person's income, in exercise of its sovereignty.[173]

2.3.1.6 Economic Allegiance of the Activity/Property (Source-based Taxation)

Although all income taxes ultimately fall on persons, the jurisdiction of a state where income yielding activities are located to tax that income, even when the taxpayer is resident overseas, is well-established in international law.[174] Source entitlement permits a state to tax income arising from within its geographical borders but accruing to non-resident persons.[175] Therefore, when a state asserts entitlement to tax the income of a non-resident person, especially, we ask whether that non-resident person is the beneficiary of an income earning activity AND whether that activity takes place (wholly or partly) within the territory of the state.[176] An affirmative determination of these questions elicits the inference that there is sufficient nexus between the state and the income to warrant the exercise of tax jurisdiction.

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[173] The question that may arise here is whether the resident country is entitled to tax the person's entire income or only so much of it as is derived from the home jurisdiction. Again, this is a matter of sovereign discretion. Traditional wisdom was for countries to tax the worldwide income of the resident, with, perhaps, allowances for taxes paid overseas (tax credits or deductions). Worldwide taxation was deemed necessary to attain equity between taxpayers that are resident within a country (ability-to-pay theory). Worldwide taxation is also deemed as necessary to ensure efficiency (capital export neutrality). In this sense, (supplementary) worldwide taxation at residence can help to remedy investment distortions that may otherwise arise from differences in tax rates between potential source jurisdictions. This way capital will be deployed efficiently rather than targeted towards low-tax jurisdictions where it may be less productive. See, for instance, Peggy B Musgrave, "Interjurisdictional Equity in Company Taxation: Principles and Applications to the European Union", in S Cnossen, ed, *Taxing Capital Income in the European Union: Issues and Options for Reform* (Oxford, 2000) 46 at 49 ["Source taxation alone, without the protective overlay of residence taxation, will, however, be nonneutral except in the unlikely event that tax rates are universally equal. Furthermore, without this 'umbrella effect' of residence taxation, jurisdictions are exposed to tax competition resulting in possible inefficiency in the fiscal conduct of the public sector... Interjurisdictional co-operation is therefore needed to achieve neutrality either through general application of the residence entitlement with use of a full foreign tax credit or by adoption of equal or approximately equal effective rates of tax in all countries"] ["Interjurisdictional Equity"].
[174] See Oats, Miller & Mulligan *supra* note 164 at 48; Avi-Yonah *supra* note 2 at 27.
[175] Musgrave, "Interjurisdictional Equity" *supra* note 173 at 47.
[176] The main criticism of the source or territoriality principle is that the source of income is difficult to define. This stems from the fact that income is often attributable to multiple potential "sources", some of which may be located in different countries. Avi-Yonah *supra* note 2 at 27–28.

The 'activity' is the subject of taxation in the context of source-based taxation. Although it is taken for granted that it is an income generating activity that can be taxed[177], the range of economic activities that can generate or contribute to the generation of income is unlimited. Experientially, they include things like entrepreneurship, labour, cultivation, harvesting, mining, construction, installation, transportation, manufacturing, financing, R&D, licensing, advertising, marketing, and sales. Therefore, source, as an economic concept, is determined with primary reference to underlying factors such as the location of those mentioned above.[178] Each of these factors is seen as contributing, whether wholly or in part, to the creation of wealth[179]; and it is often the interaction of various factors/activities that creates wealth.[180]

The tax laws of most countries classify economic activities into different categories and subcategories. For instance, the provision of labour may be subcategorized into employment or independent contracting.[181] The use of assets may be subcategorized in many ways including use of immovable property, use of movable property, use of tangible property and use of intangible property.[182]

There is also a common classification of income into "active income" or "passive income". Active (business) income refers to income derived from direct exertion by the taxpayer in a business activity or, otherwise carrying out some activities such as an employment.[183] This form of income

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[177] This also implies that only payments or benefits that are made or received in connection with a productive activity are taxable. The usual distinction is between acts or activities of a personal character and those where there is some intention or prospect of producing income (creating wealth) – Harris & Oliver *supra* note 130.
[178] See Fred B Brown, "An Equity-Based, Multilateral Approach for Sourcing Income Among Nations" (2011) 11 Fla Tax Rev 565 at 570-575.
[179] See Li, Cockfield & Wilkie *supra* note 146 at 24.
[180] The development of tax law has benefited from the theoretical contributions of classical economists like Adam Smith, for instance, who defined income in terms of four productive sources: wages from labor, profits from trading, interest on capital, and rent on land. See Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, 1776 (Chicago: University of Chicago Press, 1976).
[181] Harris & Oliver *supra* note 130.
[182] *Ibid.*
[183] Li, Cockfield & Wilkie *supra* note 146 at 27.

requires the combined provision of labour and use of assets and may be subcategorized into things like agricultural business, banking business, insurance business, construction business, etc.[184] Passive income usually accrues to the taxpayer as a result of another person using the taxpayer's assets and takes the form of dividends, interest, rent, or royalties.[185]

Under subsection 2(3) of the Income Tax Act (ITA) the income of a nonresident person is taxable in Canada in three instances: (1) if that person is employed in Canada; (2) has carried on a business in Canada; or (3) has disposed of a taxable Canadian property.[186] A different segment of the ITA (Part XIII) provides for the taxation of passive income such as interests, dividends, rents, and royalties derived from Canada. The law requires tax on such incomes to be paid in the form of withholding tax.

There are two steps to ascertaining whether a person's income is taxable under a schedular system, such as operative in many countries.[187] First, we must examine an activity to ascertain whether it falls within one of the categories or schedules referred to in the tax law.[188] Second, one must identify payments made or received by a person as connected to or arising out of that activity, in other words, determine that a payment has a sufficient nexus with the activity.[189]

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[184] Harris & Oliver *supra* note 130.
[185] Li, Cockfield & Wilkie *supra* note 146 at 27.
[186] ITA, subsection 2(3).
[187] Under a schedular tax system, each source of income is subject to a specific schedule. In contrast, a global or comprehensive tax system applies the same tax schedule to the sum of all sources of income. Laurence Jacquet & Etienne Lehmann, "How to Tax Different Incomes?" (2021) CESifo Working Paper 9324.
[188] This step is taken on a case-to-case basis. For instance, one might have to ascertain whether a payment amounts to dividend or interest or whether a person's activity qualifies them as an employee or independent contractor. There may be situations where the same activity gives rise to more than one tax categorization. A good example is rent from land which may in some circumstances also qualify as business income. Indeed, some passive income received by taxpayers would ordinarily qualify as business profits but for the carveouts that exist in a scheduler system.
[189] Harris & Oliver *supra* note 130. ["Again, this is a question of degree and not absolutes and it may not be clear whether a particular payment should be allocated to one activity or another, i.e. it may have a dual nexus. In such a case, the domestic tax law will either allocate the whole of the payment to one activity (which may be a non-earning activity) or apportion the payment between activities, a necessarily more complex process"].

Finally, income tax laws contain so-called “source rules” that connect taxable activities to their jurisdiction.[190] For Canada, the source rules are embedded in the charging clause, for instance, subsection 2(3) ITA, which clearly stipulates that only that portion of a non-resident person’s income that is “*earned in Canada*” is taxable in Canada. This stipulation is supplemented by other provisions of the ITA, e.g., subsection 115(1), which severally refers to “incomes from duties of offices and employments *performed* by the non-resident person *in* Canada”, and “incomes from businesses *carried on* by the non-resident person *in* Canada”. These provisions require a connection between the payment and some activity performed or carried on in Canada by the payee. Also, a non-resident person’s passive income (including interest, rents, and royalties) is subject to Canadian tax only if the relevant amount is paid or credited by a person *in* Canada.[191] These provisions leave no doubt – at least in principle – about the scope of taxation of non-residents contemplated in the statute. Only payments that flow from (a source in) Canada are subject to tax in Canada.

To sum it up, a valid basis on which a state can exercise jurisdiction to tax income arising from a particular activity (or property) is that the activity takes place (or is located) within that country. There must be a sufficient nexus between the income and the activity. Economic allegiance owes to a state where income earning activities are located. A sovereign state has jurisdiction to define the degree of activity that constitutes a sufficient connection, even though it is worth stipulating that as regards active income (business or employment) states typically stipulate a threshold of physical presence of the non-resident person in the jurisdiction to trigger the exercise of jurisdiction. These are long-standing global norms, but as I discuss in Chapter 3, significant

[190] *Ibid.*
[191] ITA, subsection 212(1).

developments in the way economic activities are carried out in more recent years has made countries to reconsider the conventional thresholds, especially for taxation of active business income. In the meantime, at a basic normative level, a state is simply entitled to exercise tax jurisdiction over income earning activities that take place there.

2.3.1.7 Administrative Competence to Tax

A state's tax jurisdiction is not defined by economic-political theory alone. It has been observed that whether there is any limitation on a state's taxing power with respect to international or foreign dealings will be determined by domestic constitutional law, customary international law, *administrative considerations* and, of course, any treaty limitations.[192] Administrability constitutes a check on tax jurisdiction. If a tax is difficult to administer, or if compliance burdens, regardless of how perfect it may seem in theory or design, the tax will fail to serve its intended purpose as a source of revenue.[193] Harris & Oliver rightly suggest that the customary international law requirement of some sort of connecting factor, some link to a state in order for that state to have a recognizable jurisdiction to tax might be no more than a reflection of the fact that, if there is no connecting factor, a state will find it near impossible to enforce its tax outside its territorial limits.[194] Some of the arguments proffered for and against residence or source jurisdiction taxation are partly anchored on administrability. As Ring observes:

> Residence jurisdiction could be preferred on the grounds that: (1) It best reflects ability to pay (because the taxing state can "readily" base its taxation on the entirety of the taxpayer's income and thus have an accurate sense of the taxpayer's fiscal picture). (2) Income "belongs" to people (residence), not places (source). (3) <u>People are less mobile than activities</u>. (4) <u>The source approach would put tremendous pressure on the definition of source</u>. Alternatively, source jurisdiction could be preferred: (1) The source country provides the infrastructure permitting the creation of the income (the benefits principle).

[192] Harris & Oliver *supra* note 130 at 43–44.
[193] Li, Cockfield, & Wilkie *supra* note 146 at 22
[194] Harris & Oliver *supra* note 130 at 44

(2) The source country may be aware of the income's existence and hence better able to capture the tax. (3) The source country *can* tax it.[195]

These observations are instructive because countries typically do not enforce the tax obligations of one another;[196] and only a few countries have mutual collection language in (some of) their treaties.[197] Moreover, the constantly evolving problems of capital mobility, information asymmetry (between taxpayers and tax jurisdictions) and aggressive tax planning, often facilitated by sophisticated tax planning, conspire to challenge the fiscal sovereignty of countries and, perhaps, "incentivize" countries to define their tax jurisdiction more pragmatically.[198]

The forms of nexus that exist (person or activity/property) shapes the way countries structure their tax systems for effective exercise of tax jurisdiction. Conventionally, countries classify the taxable income base into two broad streams, for administrative reasons. The common practice is to tax

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[195] Diane Ring, "International Relations Theory" *supra* note 2 at 117.

[196] Alan R. Johnson, Lawrence Nirenstein & Stephen E. Wells, "Reciprocal Enforcement of Tax Claims through Tax Treaties" (1979) 33:2 Tax Law 469; Brena Mallinak, "The Revenue Rule: A Common Law Doctrine for the Twenty-First Century," (2006) 16:1 Duke J Comp & Int'l L 79 ["The revenue rule, a common law doctrine with origins in the eighteenth century, is a battleground in the twenty-first century… In its modern form the revenue rule generally allows courts to decline entertaining suits or enforcing foreign tax judgments or foreign revenue laws"]; Matthews Vattamala, "The Myth of Cross-Border Cooperation: Mutual Assistance for the Collection of Tax Claims in Cross-Border Insolvencies" (2013) 29 Emory Bank Dev J, SSRN https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2128763.

[197] Only a few countries, including the U.S. and Canada, have collection language in their tax treaties. See: Canada – United States: Income and Capital Tax Convention 1980, as amended through 2007, Article XXVI A(1) ["The Contracting States undertake to lend assistance to each other in the collection of taxes referred to in paragraph 9, together with interest, costs, additions to such taxes and civil penalties, referred to in this Article as a "revenue claim"]; Keith Fogg, "International Collection Efforts by the IRS – Expanding the Number of Treaties in which We Have Collection Language", *Forbes* (18 November 2014) online: https://perma.cc/Q2EE-PVXQ; Sunita Doobay & Stanley C Ruchelman, "Collecting Another Country's Taxes – Recent Experience in the Canada–U.S. Context", *Blaney McMurtry LLP* (Nov 2019) online: https://perma.cc/LB46-BNE5. As of 2021, 144 countries and jurisdictions have signed up to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (developed in 1988 and amended by Protocol in 2010), an instrument that includes all possible forms of administrative cooperation between countries in the assessment and collection of taxes. However, countries can opt out of the collection requirements in the Convention, and this has been the practice for many. Canada has ratified the Convention largely for information exchange purposes but reserves mutual collection for specific bilateral treaties. The implication is that, at least for now, the revenue rule remains prevalent.

[198] Much has been written on the inter-connected issues of international tax competition and international tax abuse (evasion and avoidance) and their impact on tax sovereignty. This thesis does not delve deeply into these issues, but they are touched upon in chapter 3. For a greater exploration of these issues, see, for instance Peter Dietsch, *Catching Capital: The Ethics of Tax Competition* (Oxford: Oxford University Press, 2015); Ivan Ozai, "Tax Competition and the Ethics of Burden Sharing" (2018) 42:1 Fordham Int'l LJ 61 at 65–71.

active income at source, on a net basis by assessment (that is, after allowing for costs of earning income) because the activity by the non-resident taxpayer to produce the income generally means that there is a sufficient presence in the source country to rely on filing and assessment of a tax return.[199] In contrast, passive income is taxed by withholding by the payer at source on a gross basis.[200] Indeed, the withholding tax emerged as the principal means of taxing non-residents because of the administrative convenience such an approach offered.[201] Generally, there is no sufficient presence of the person deriving the income in the source jurisdiction to enforce payment after the income has 'escaped' the country, and correspondingly there is no means of enforcing lodgment of returns or verifying deductions through a tax return process.[202]

The rates of tax on such income are generally flat rate and low, reflecting two related factors: an implicit allowance for some expenses, as well as a policy preference for very limited source taxation (apart from income from land) perhaps on the basis that the benefit obtained by the person deriving the income from the source jurisdiction is less than in the case of active income.[203]

There is scope for flexibility in defining a country's tax jurisdiction by administrative competence. Administrative competence is a constantly evolving factor, and experience shows that countries can either make strides in administrative capacity that enable them to more effectively assert tax jurisdiction or lose ground due largely to the dynamism of economic activities or the adaptability of taxpayers and tax planning. Tax administration is not today what it used to be a century ago when the framework for international tax (jurisdictional) principles were defined and partly

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[199] Richard Vann, "Current Trends in Balancing Residence and Source Taxation" (Sydney Law School, Legal Studies Research Paper N. 14/107: 2014).
[200] *Ibid.*
[201] Hugh J Ault, "Corporate Integration, Tax Treaties and the Division of the International Tax Base: Principles and Practices" (1992) 47:3 Tax L Rev 565 at 570.
[202] Vann *supra* note 199.
[203] *Ibid.*

constrained by administrative considerations. To begin with, the notion that residence jurisdiction could be preferred because it best reflects ability to pay (because the taxing state can "readily" base its taxation on the entirety of the taxpayer's income and thus have an accurate sense of the taxpayer's fiscal picture), to paraphrase Diane Ring, is no longer tenable because of the incidence of capital mobility, which signifies the growing capacity of corporations and high net worth individuals, especially, to move their income across borders and to locate income away from their countries of residence.[204] As Brooks & Krever explain:

> Since the early days of treaty design spearheaded by the League of Nations, times have changed dramatically. Globalization, financial innovation, and increased reliance on services and intangibles as the key generators of business profit have undermined or largely eliminated the potential for simpler administration of residence-based taxation.[205]

It has been proven consistently that the system put in place decades ago is no match for the ingenuity of lawyers and bankers armed with increasingly sophisticated telecommunications technology and tax planning techniques.[206] In short, residence-based taxation no longer enjoys that acclaimed administrative advantage over source-based taxation. Therefore, the delineation of tax jurisdiction that is based on that dichotomy no longer holds water.

Tax administration in many countries has consistently strived for greater efficiency and efficacy.[207] Tax authorities continue to deploy more capable administrative tools, to expand audit and collection capacities and, generally, have better access to taxpayer information. Unlike the post-

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[204] Dietsch, "Catching Capital" *supra* note 198.
[205] Brooks & Krever *supra* note 17 at 165.
[206] Prem Sikka & Mark P. Hampton, "The Role of Accountancy Firms in Tax Avoidance: Some Evidence and Issues" (2005) 29:3 Accounting Forum 325; Steven A Dean, "A Constitutional Moment in Cross-Border Taxation" (2021) 1:3 J on Fin for Dev 1 at 10 [accepted paper].
[207] See, e.g., OECD, *Tax Administration 2021: Comparative Information on OECD and Other Advanced and Emerging Economies* (Paris: OECD Publishing: 2021) at 3 ["One of the trends identified in this and recent editions of the Tax Administration Series has been the increase in e-administration over recent years, with tax administrations investing significant resources in moving more of their processes online. This has not only enhanced service delivery, reduced burdens and improved compliance, but it has also made us more resilient."]

Second World War period which was marked by "a total absence of interinstitutional collaboration", since the 1970s, there has been a gradual shift towards transparency and exchange of taxpayer information between jurisdictions, a shift that has grown exponentially since the 2008 global financial crisis and the subsequent launch of the OECD transparency initiatives.[208] The fiscal challenges that attended that situation spurred the political will in HIDCs, especially, to equip tax authorities with greater information tools. As a consequence, many countries have relaxed their financial secrecy regimes, and there is now a large network of bilateral transparency and exchange of information agreements, as well as a Common Reporting Standard (CRS) for automatic exchange of tax information, a new standard of tax cooperation – adopted by over 100 countries – which compels financial institutions to identify and report to their home tax authority certain accounts held by or for the benefit of non-residents.[209] There is also a multilateral reporting standard – also ratified by over 100 countries – that requires MNEs to file tax information about their global operations in each jurisdiction of operation.[210] Despite their perceived shortcomings[211],

[208] Alberto Barreix, Jeronimo Roca & Fernando Velayos, "A Brief History of Tax Transparency" (2016) Institutions for Development Sector Fiscal and Municipal Management Division Discussion Paper No. 1DB-DP-435.

[209] See OECD, *Declaration on Automatic Exchange of Information in Tax Matters* (OECD, 6 May 2014); Section 270 ITA Canada. The declaration elaborates on Articles 4 & 6 of the Convention on Mutual Assistance in Tax Matters relating to exchange of information for tax collection purposes.

[210] OECD, "Guidance on the Implementation of Country-by-Country Reporting" (Paris: OECD, 2018). See subsection 233.8(3) ITA of Canada ["a report in prescribed form… in respect of a reporting fiscal year of an MNE group, shall be filed in prescribed manner with the Minister on or before the date prescribed in subsection (6)…".] Taking the tax transparency scheme to a higher level, the European Union is on a path to installing a public country-by-country (CBCR) directive, which will require MNEs operating in the EU single market to publicly disclose some key operational and tax payment information on a CbC basis. See Council of the EU, "Public country-by-country reporting: Council paves the way for greater corporate transparency for big multinationals" (28 sept 2021) online: https://perma.cc/QL4P-5NKN.

[211] See for instance, Oladiwura A Eyitayo, "Profit Shifting by Canadian Multinational Corporations: Prospects of Reversal under Canada's Country-by-Country Reporting Rules" (2018) 26 Dalhousie J Legal Stud 79 [arguing that Canada's draft Country-by-Country Reporting Rules were not sufficient for their purpose – combatting base erosion and profit shifting]; Arco CP Bobeldijk & Paul Klaaseen, "Country-by-Country Reporting and the Effective Tax Rate: How Effective Is the Effective Tax Rate in Detecting Tax Avoidance in Country-by-Country Reports?" (2019) 47:12 Intertax 1057 [arguing that the effective tax rate calculated based on the country-by-country report cannot be accurately used in high level risk analyses of tax avoidance]. Annet Wanyana Oguttu, "The Challenges of Implementing Country-by-Country Reporting in Developing Countries and the Case for Making Public Country-by-Country Reporting Mandatory" (2020) 12:1 World Tax J 102 [arguing that the absence of a public CbCR regime hampers the capacity of developing country tax administrations to access CbC reports].

these measures, undoubtedly, take tax administration to unprecedented levels of sophistication and efficacy.[212]

One development that could better equip tax authorities to tax the economic activities of non-residents especially in the digitalized economy is the digital transformation of tax administration. There has been a steady digital modernization of tax administration in many countries, including developing countries where measures like eFiling for domestic revenue and the use of electronic cash registers for VAT have since been introduced to enhance efficiency.[213]

There are various levels of digital transformation – with implications for tax collection capacity – and countries operate at these various levels. Tax consultants, Ernst & Young, categorized the levels of tax authority digital transformation into five: 'E-file', 'E-accounting', 'E-match', 'Eaudit' and 'E-assess'.[214] These categories range from the use of standardized electronic forms for filing tax returns, at the 'basic' end, to tax authorities using submitted data to assess tax without the need for tax forms, at the most advanced end.

Despite the (technological) gains made in tax administration, significant challenges remain. A recent survey involving eight developed and developing economies chronicles several ways in which tax administration has evolved in recent years in adaptation to, and leverage of, digital

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[212] See Felix Hugger, "The Impact of Country-by-Country Reporting on Corporate Tax Avoidance" (2019) ifo Working Paper No. 304 [finding, in part, that CbCR reduces the shifting of profits from high tax jurisdictions]; Preetika Joshi, *et al,* "Does Public Country-by-Country Reporting Deter Tax Avoidance and Income Shifting? Evidence from the European Banking Industry" (2020) 37:4 Contemp Acc Res 2357 [finding, generally, that increased transparency from CbC reporting can deter tax-motivated income shifting].

[213] Odd-Helge Fjeldstad, "Taxation and Development: Donor Support to Strengthen Tax Systems in Developing Countries" (2014) 34:3 Pub Admin & Dev 182 at 15.

[214] Garima Pande & Rahul Patni, "Tax Technology and Transformation: Tax functions 'go digital'", *EY* (2020) online: https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/digital/ey-tax-technology-transformation.pdf.

advancements.[215] Important (but varying from country to country) gains have been made in the areas of local and cross-border data collection and storage.[216]

At an advanced level, tax administration systems would be integrated and consolidated with the natural ecosystem of business and regulatory framework (e.g., accounting systems, financial institutions, digital service platforms, cryptocurrency platforms and payment systems).[217] The integration allows taxes to interact seamlessly as a business transaction occurs, whereby taxes are collected and verified in (near) real-time.[218] Unfortunately, none of the sampled countries yet operates at this level.[219]

Various tax authorities operate at an intermediate level where they can leverage information technology to collect, and efficiently and accurately analyze taxpayer data. In such systems, the registration, submission, and payment process for all tax types (personal income tax, value added tax/goods and services tax (VAT/GST)), are also digitalized.[220]

The tax authorities, from mostly developing economies, were adjudged to operate at a 'limited' digital response level, where tax administration systems are not digitalized, partially digitalized for certain tax types (such as VAT/GSTs) or digitalized with the ability to access third party data,

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[215] Helena Strauss, Tyson Fawcett & Danie Schutte, "An Evaluation of the Digital Response of Tax Authorities to Optimise Tax Administration within the Digitalised Economy" (2020) 18:2 eJ Tax Research 382 at 389. The countries sampled were Australia, China, Finland, India, the UK, the United States, New Zealand, and South Africa.
[216] The authors record that various information technology maturity levels can be observed among international tax authorities, ranging from the mere digitization of manual tax returns to a maturity level where tax returns are pre-populated for taxpayers and taxes are collected and verified in (near) real-time. Some of the leading countries with regards to digital tax ecosystems include, but are not limited to, Australia, China, Italy, Russia, New Zealand and the United Kingdom, while some African and Asian Pacific countries are only in the inception phases of digitizing traditional tax returns for selected tax types. *Ibid* at 384
[217] *Ibid.*
[218] *Ibid.*
[219] *Ibid.*
[220] *Ibid.*

prepopulate tax returns and calculate the tax liability, but the data used is inaccurate and incomplete.[221]

These results show that the digital focus of tax administrations is aimed at simplifying tax compliance, optimizing tax administration, utilizing data to improve taxpayer services, systems and operating systems, facilitating international cooperation in tax matters, and attaining a holistic national and international system of dealing with taxpayers.[222]

Technology bridged some of the administrative gaps between states and non-residents. The improvements in tax administration over the years diminish the traditional constraints to tax competence because states now have a better reach to assess tax on non-residents. However, while most countries have registered tremendous progress in administrative capacity, it is also apparent that there is significant room for improvement especially in a potential atmosphere of unilateral digital economy tax enforcement. Greater integration between tax administration and payment systems, especially in developing economies, will, undoubtedly, enhance the capacity to assert tax jurisdiction across their borders.

In sum, tax competence rests on a combination of economic-political factors that are deemed to confer tax jurisdiction on a state, as complemented by the feasibility of administering a tax potentially imposed by a state on a cross-border tax base. It is only with these competence defining factors in place that a state can enter the fray of an international regime that streamlines *when and/or how* tax jurisdiction is exercised.

[221] *Ibid.* As the authors observe, migration to real-time tax collection in developing economies remains impeded by challenges such as budgetary constraints, capability shortages, insufficient internet connectivity, lack of political support, political interference, IT illiteracy of taxpayers and cultural preferences of taxpayers.
[222] *Ibid.*

2.3.2 Does the Compromise Impair (the Exercise of) Tax Jurisdiction?

Once it is established that a country has sufficient normative competence to assert tax jurisdiction, the next factor to consider in the RIC analysis is whether an international tax compromise which that country is involved in impairs its exercise of tax jurisdiction. Any limit on the exercise of tax jurisdiction that is not inherent in the competence factors discussed in the previous section would constitute an impairment. Impairments may take the form of tax rate restrictions and hikes in the threshold of connection to the country that is required to exercise tax jurisdiction. In the latter case, we can quickly refer to things like the requirement that a non-resident employee spend a lengthy number of days in a source country before that country can tax their income. The stipulated number of days is a threshold compromise that fetters the right of the country to tax income – however significant – that is derived in a fewer number of days. Countries may agree to a more limited threshold (impairment) with regard to another class of income such as, for instance, income derived by an artist or entertainer. This is, generally, the nature of international tax compromise.

The analysis that follows in this section – and for most of the thesis – focuses on the impairment of source taxation, for a few reasons. First, as Peggy Musgrave rightly observes, there is little doubt that the source jurisdiction is in a more favourable position to tax income accruing to non-residents, and source entitlement is generally regarded as the primary right to tax and is more emphatically asserted in tax agreements and model tax treaties.[223] Second, the current international tax climate lends itself to a renewed reassertion of source jurisdiction on the backdrop of an international tax regime that has predominantly constrained source taxation. The push for a new global tax deal (chapter 3) that is largely being orchestrated on the OECD platform is a culmination of agitations by countries for a more robust source taxing rights allocation. Third, inter-nation

[223] Musgrave, "Interjurisdictional Equity", *supra* note 173 at 49.

equity arguments tend to focus on the impact of the existing tax compromises on the taxing rights of LIDCs and, given that most LIDCs are predominantly identified in those discussions as source jurisdictions, it makes contextual sense to focus on source taxation. Adopting this approach thus fits with the objective of projecting RIC as a framework that emphasizes reassertion of fiscal self-determination for LIDCs.[224]

It is beyond contention that much of what the international tax regime, as a compromise on the allocation of taxing rights, does is to impair the international tax jurisdiction of countries. The double taxation regime, in particular, was designed with the primary aim of restricting the exercise of tax jurisdiction. Countries were expected – or required – to "give up" taxing rights primarily to address double taxation.[225] The restrictions that were agreed internationally are reflected as norms in the domestic tax legislation of countries, as well as, even more restrictively, in tax treaties. Tax treaties, notably, suppress tax jurisdiction (especially source tax jurisdiction) through their embodiment of restrictive concepts like the permanent establishment principle for taxation of active business income and rate limits for taxation of passive income. A restrictive threshold stipulation such as the permanent establishment rule effectively narrows the scope of in-country activities that would be subject to tax if a pre-compromise jurisdictional status was maintained.

The next section of this paper discusses the current state of international tax compromise which has subsisted for a century. As I note earlier, this compromise is embodied in a network of about four thousand tax treaties as well as in the domestic tax legislation of individual countries.[226]

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[224] I should stress that my decision to focus on source alone is also informed by a desire to narrow the scope of the work. The framework can also function more generally.

[225] Michael Lang, *Introduction to the Law of Double Taxation Conventions* (Amsterdam: IBFD, 2013) at 30; Stjepan Gadzo, *Nexus Requirements for Taxation of Non-Residents' Business Income: A Normative Evaluation in the Context of the Context of the Global Economy* (Amsterdam: IBFD, 2018) at 2.

[226] Tembo Nakamoto & Yuichi Ikeda, "International Tax Avoidance Investigated from A Network Science Perspective" in Y Ikeda, H Iyetomi & T Mizuno, eds, *Big Data Analysis on Global Community Formation and Isolation: Sustainability and Flow of Commodities, Money, and Humans* (Singapore: Springer, 2021) 249 at 285.

However, as I also note at the beginning of this chapter, it is patently impossible to discuss the entire body of tax compromise in detail. Therefore, I adopt a modular approach to the analysis. Admittedly, the most suitable framework for this analysis is the OECD MTC. In 2.3.2.1, I examine some of the ways in which the OECD MTC, as a proxy for the whole international tax regime on the allocation of taxing rights between residence and source countries, as well as source states *inter se*, impairs the taxing rights of source countries. In 2.3.2.2, I attempt to explain, briefly, some of the rationales for international tax compromise, i.e., the considerations that drive countries to surrender their taxing rights. In 2.3.2.3, I use, "histo-political" and critical approaches to examine the foundations of the subsisting international tax regime, bearing in mind that without these perspectives, we cannot fully appreciate the context of fiscal self-determination that countries now crave.

2.3.2.1 The League of Nations/OECD Allocational Compromise

Perhaps, the League of Nations label in the above heading may come across as a bit misleading. This is because I make no effort in this section to attribute the framework that I discuss here – the OECD MTC[227] – to the League of Nations, the body which is often credited with laying the theoretical and technical building blocks of that framework. That version of things I reserve for the eventual section 2.3.2.3. But, in the same instance, I consider it necessary to place the label in that headline to provide a glimmer of the historical source of the discussed framework and to lay some foundation – albeit slim – for the conversation that follows in 2.3.2.3. In this section, I focus wholly on a doctrinal analysis of select provisions of the OECD MTC that are relevant to the allocation of taxing rights.

[227] The OECD Model Convention with Respect to Taxes on Income and on Capital 2017.

The OECD MTC is a model convention on the taxation of cross-border income and capital.[228] It comprises 32 articles, some of which prescribe formats of taxing rights allocation. Some of the first major demonstrations of compromise in the OECD MTC are the tie breaker rules which help to assign tax residence to one country in a situation where a person is adjudged a dual resident under the domestic law of both contracting states.[229] The tie-breaker clause overrides the domestic law specifications of residence, for the purpose of the tax treaty, a good recipe for tax certainty, and also provides a platform ("mutual agreement") to resolve conflicting positions on residence.[230]

The OECD MTC, recognizes and maintains the primary right of the source country to tax income from immovable property (including income from agriculture or forestry).[231] However, the language of Article 6 is not exclusive, which implies that the country of residence may tax the residue of income derived by its residents from immovable country, likely, with a credit or deduction for the tax paid at source.

Article 7 of the OECD MTC awards the primary right to tax profits from active business to the country of residence. The exception is where an enterprise carries on business through a permanent establishment in the source country.[232] In that case, the source country can tax the income to the extent that is attributable to the permanent establishment. In this all-important case, it is the source country's taxing rights that are mostly impaired. This is expressive in the details of the permanent establishment threshold. Article 5 provides an elaborate explanation of a permanent establishment. It defines the term as "a fixed place of business through which the business of an enterprise is

[228] OECD MTC, Article 2.
[229] OECD MTC, Article 4(2) & (3). For some recent analyses of tie-breaker rules in the OECD MTC, see Timothy Borg Olivier, "Developments in the Analysis of the Tie-Breaker Rules for Individuals Under Article 4(1) OECD" (2017) 45:1 Intertax 82; Cosima Gerlach & Nicola Niemeyer, "The New Tie Breaker-Rule for Companies According BEPS Action Point 6: A (Too) Radical Change?" (2018) 46:10 Intertax 753.
[230] OECD MTC, paragraph 4(2)(d).
[231] OECD MTC, Article 6.
[232] OECD MTC, Article 7.

wholly or partly carried on."[233] The term includes a place of management, a branch, an office, a factory, a workshop, and a mine.[234]

Some hugely significant impairments can, however, be found in the things that are excluded. For instance, a building site or a construction or installation project does not constitute a permanent establishment unless it lasts for more than twelve months.[235] By virtue of paragraphs 5(4)(a) & (b), the use of facilities or maintenance of a stock of goods or merchandise for the purpose of storage, display or delivery would not constitute a permanent establishment. The implication of these exclusions is that a source country's right to tax income outflows that emanate from these activities is severely impaired regardless of the size of those outflows.

Article 8 deals with taxation of profits from international shipping and air transport. It exclusively reserves the right to tax this form of income to the state of residence of the shipping enterprise, again, regardless of the amount of profits derived from the source state.

Based on the schedular model, various categories of passive income are contained in the OECD MTC framework. These include dividends[236], interest[237], and royalties.[238] In most cases, the OECD MTC restricts source taxation rather than residence taxation. In the case of dividends, paragraph 10(2)(a) of the OECD MTC stipulates that both the residence and source states may tax dividends paid by a company in the source state to a resident of the other state. However, where the recipient of the dividends is their beneficial owner and holds directly at least 25% of the payer

[233] OECD MTC, Article 5(1)
[234] OECD MTC, Article 5(2).
[235] OECD MTC, Article 5(3).
[236] OECD MTC, Article 10.
[237] OECD MTC, Article 11.
[238] OECD MTC, Article 12.

entity, the tax charged by the source state shall not exceed 5% of the gross amount of dividends. In cases where these ownership qualifications are not met, the tax shall not exceed 15%.

In respect of interest payments, article 11 of the OECD MTC stipulates, generally, that both the resident and the source state may tax. However, the source state shall not tax at a rate exceeding 10% of gross payment where the recipient is also the beneficial owner.

Article 12 is even more restrictive of source country taxation. It stipulates that royalties arising in a contracting state and beneficially owned by a resident of the other contracting state shall be taxable only in the other state. In essence, this stipulation excludes source taxation of royalties, provided that the recipient of the payments is also their beneficial owner.

Other restrictions are discernible from the provisions of article 13(2) & (4) which specify that capital gains derived by the resident of a contracting state from the alienation of property such as ships, aircrafts (operating in international traffic), and intangibles are only taxable in the state of residence. In each of these cases it does not matter where the gains are realized from. The source country – the country where the payment emanates from – is entirely constrained from exercising its right to tax the gains. So, hypothetically, if a UK-resident enterprise that carries on international shipping business gainfully offloads one of its used vessels to a Nigeria-resident shipping enterprise, in principle, Nigeria, as a source state, would be entitled to tax the gain. However, Nigeria cannot do so under the OECD MTC framework, which effectively impairs (suspends) the exercise of Nigeria's right to tax. The same goes for gains realized from the alienation of intangibles such as patents, knowhow, and copyrights by the resident of one country to the resident of another.

The notion of impairment in the OECD MTC is visible and ubiquitous in part because of the broad settlement of tax norms midwifed by the OECD as "international best practice".[239] The domestic rules of most countries mirror these patterns of impairment, albeit sometimes at less restrictive levels. In some cases, domestic source rules have a broader scope than the OECD MTC envisages. In such cases, a country that follows the OECD MTC for its tax treaties accepts a more restrictive effect on its jurisdiction than it already entrenched domestically. It means that the dictates of domestic legislation become secondary, as reference can simply be made to the applicable tax treaty to determine the appropriate taxation of a non-resident.[240] However, in circumstances where domestic law source rule are narrower than that in tax treaty stipulations (based on the OECD MTC) or where there is no domestic charge to tax on a type of income that the treaty permits the source country to tax, the treaty is only permissive and will not ground a charge to tax.[241]

In sum, the compromise that reigns in the international tax regime is that residence countries should yield primary tax jurisdiction to source only with respect to certain income types (active business income and income from immovable property) while source countries should yield substantial taxing rights to residence countries for other kinds of income (e.g., passive income and capital gains). Yet, the right to tax active business profits at source is also significantly impaired by the permanent establishment requirement. To reiterate, these compromises are entrenched, not just in various tax treaty models, but also in bilateral tax treaties and domestic tax legislation.

States, including LIDCs, lose significant tax revenue from mere participation in a compromise-based system of international taxation.[242] For instance, a state that accepts to not tax business

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[239] For use of the phrase in relation to the OECD's development of tax norms, see JC Sharman, "Seeing Like the OECD Tax" (2012) 17:1 New Pol Econ 17 at 21.
[240] Harris & Oliver *supra* note 130.
[241] *Ibid.*
[242] See Petr Janský & Marek Šedivý, "Estimating the Revenue Cost of Tax Treaties in Developing Countries" (2018) 42:6 The World Econ 1828.

profits arising from its borders unless a certain high-bar physical presence threshold is met or that accepts to tax cross-border interest outflows at a reduced rate or altogether forgoes its right to tax royalty payments to non-residents implicitly agrees to surrender potentially significant chunks of revenue. Conventional wisdom suggests that since these are sovereign states with subjective interests (including important domestic revenue mobilization goals) there must be some good reason why they take the "counterintuitive" path of surrendering their taxing rights. It, therefore, makes sense to dig, even briefly, into the fundamental reason(s) why sovereign states compromise their tax jurisdiction. I do so in the next section.

2.3.2.2 Why Do Sovereign States Compromise Tax Jurisdiction?

A state may compromise the exercise of its tax jurisdiction for a variety of reasons. The main one is that countries give up taxing rights to alleviate the burden of double taxation on foreign capital, which is regarded as inimical to international trade and investment.[243] Second, a capital poor country may desire to attract foreign capital investment from a capital rich country, and therefore execute a tax treaty with favorable tax concessions to investors from the latter country.[244] Likewise, a country that is keen to attract the import of technology may compromise its right to tax royalty payments made to non-resident owners of intangible assets. Cooperation and compromise are also ways of showing that one is part of the international tax community; and the opposite posture may be self-isolationist.[245] It seems, in this sense, that for LIDCs, accepting restrictions of tax jurisdiction is just a necessary evil of being a part of the international tax

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[243] See Marius Eugen Radu, "International Double Taxation" (2012) 62 Procedia – Social and Behavioral Sciences 404 ["Since double taxation affects the efficiency and competitiveness of exports of goods, external, international elimination of double taxation in order to represent a necessity to ensure an improvement of the economic relations at the international level"]; Richard L Doernberg, *International Taxation,* 5th ed (St Paul: West Group, 2001) at 2–3 [describing international double taxation as hurtful to taxpayers as well as the taxing states].

[244] Paul Baker, "An Analysis of Double Taxation Treaties and their Effect on Foreign Direct Investment" (2014) 21 Int J Econ Bus 341.

[245] See Ring "International Relations Theory" *supra* note 2.

community.[246] Perhaps more remotely, but also in the spirit of cooperation, tax jurisdiction may be compromised as part of a broader deal to secure cooperation with other states for cross-border enforcement of tax liabilities (administrability).[247]

When states engage in international tax compromises, they tend to have one or more of these rationales as a driving force. They view compromise as a way of fulfilling one or more of these policy goals, notwithstanding the consequential impairment of tax jurisdiction that ensues. However, it is worth emphasizing that the prevention of double taxation is the paramount reason why countries compromise the exercise of their tax jurisdiction. The international tax regime was built on a foundation of double tax avoidance. It has been observed that basic economic theory identifies several efficiency gains that derive from international capital mobility.[248] Companies compete globally for four reasons: (1) strong potential market internationally, (2) enhanced profitability (3) low-cost production and quality are critical to successful competition in global markets, (4) success may be achieved by selecting particular market segments.[249] Free trade in capital allows a superior utilization of resources, the spreading of risk, and ultimately a higher rate of economic growth through the adoption of higher-yield, higher-risk activities.[250] However, the

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[246] See Tarcisio Diniz Magalhães, "What Is Really Wrong with Global Tax Governance and How to Properly Fix It" (2018) 10:4 WTJ 499 [examining the power dynamics of international tax and how groups of powerful states determine the direction of the international tax regime].

[247] An example is the recent OECD Inclusive Framework tax deal which, at the behest of the U.S. combines agreement on pillar 1 (digital economy taxation) with pillar 2 (combating tax base erosion by setting a global minimum tax rate). In the past, scholars have suggested that rich countries looking to obtain the cooperation of poorer countries towards securing their own tax bases should be willing to share some of that tax base with the poorer countries to enable them to achieve their domestic distributive objectives. Dagan, "International Tax and Global Justice" *supra* note 107. Dagan contends that redistribution of taxing rights must be the price that rich countries pay for tax cooperation from poorer countries. She reasons that globalization has derailed tax sovereignty by making tax avoidance easier for residents of HIDCs – a situation which undermines the domestic redistributive policies of HIDCs. HIDCs cannot expect cooperation from LIDCs towards reasserting their tax sovereignty if cooperation does not improve or at least not worsen the capacity of LIDCs to fulfill their own domestic redistributive objectives. A just resolution is for HIDCs to adopt global redistribution policies that incorporate transfer payments by HIDCs to LIDCs.

[248] Dani Rodrik & Tanguy van Ypersele, "Capital Mobility, Distributive Conflict and International Tax Coordination" (2001) 54 J Int'l Econ 57.

[249] Simon James, "The Future of International Tax Environment" (1999) 25:1 Int'l Tax J 1 at 2.

[250] *Ibid*.

benefits of global business may be overwhelmed by the burdens of taxation, which may, potentially, disincentivize wealth creation through cross-border business activities.

Double taxation, 'the imposition of comparable taxes in two (or more) states on the same taxpayer in respect of the same subject matter and for identical periods'[251], can arise where a person owes economic allegiance to more than one country. This may be the result of dual (or multiple) residence, dual (or multiple) source or combinations of residence and source. Two countries may concurrently claim entitlement to tax the income of a person if that person is resident in one country and derives income from an activity that is located in the other country. The source country may tax the income before it leaves its borders while the residence country may also tax the income in the hands of the income earner.

Double taxation may also arise where two or more countries claim to be the source of income. This is a common phenomenon because of the integration of value chains in different countries. If two countries have normative grounds to tax the same income on the basis of source, the source jurisdictions' taxes may run concurrently with taxes imposed by the residence jurisdiction – if the taxpayer is resident in a third country. The typical way to deal with the problem is for countries to compromise their tax jurisdiction. This may be done unilaterally or in cooperation with other states.[252] Cooperation would typically require at least one state to give up some (or all) of its entitlement to tax. While like many commentators, I am willing to accept that some level of

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[251] OECD MTC.

[252] The compromise of tax jurisdiction may be done unilaterally, bilaterally, or multilaterally. Without tax treaties to share the burden of tax relief, countries would normally shoulder the responsibility of granting relief to their residents who engage in foreign trade. As far back the early 20th century, the U.S. limited the exercise of its right to tax the foreign sourced income of its residents who invested or carried on business activities abroad by granting tax credits, deductions, and exemptions. Graetz & O'Hear *supra* note 34. The adoption of a treaty-based tax relief system was copied from the Europe as a strategy for sharing the relief burden between the residence and source states. See Mitchell B Carroll, "International Tax Law: Benefits for American Investors and Enterprises Abroad" (1968) 2:4 Int'l Lawyer 692 at 692–693.

impairment to the exercise of tax jurisdiction is necessary to address the problem of international double taxation and, perhaps, to achieve one or more of the other rationales for revenue sacrifice, I am convinced, as a practical matter, that any state that is involved in such a compromise must confront the ultimate question of whether giving up all or some of its taxing rights is a reasonable choice in the context of the facts before it.

2.3.3 Is the Impairment Reasonable?

Now I turn to the third test of RIC: "reasonableness" (or "reasonable"). I am inclined to think that this is the most challenging – yet, most important – component of the trifactor test. How can we say that a restrictive tax norm – an impairment – is reasonable (or not)? Can any bright-line response to this question suffice, bearing in mind, by many accounts, that philosophical terms like "reasonableness" often defy precise denotation?[253] As I arrive this critical juncture, I am brusquely reminded of the ageless Indian parable of the (six) blind men and the elephant.[254] Deprived of the privilege of sight, each touched a different part of the elephant's body and, as if living a true synecdoche, emerged with different descriptions of the mammoth mammal. In the end, those wise blind men leveraged their divergent perspectives to arrive at some common ground.[255]

Visually impaired or not, people have different senses of what is "reasonable". I have thought through my elephant in several ways. I have thought to frame "reasonable" or "reasonableness" in negative terms, by asking: "what or how much is "unreasonable" to concede"? Perhaps, a "simple"

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[253] See Ian F. Kelly, "The Bill of Rights, the Indian Act, and Equality before the Law: The Need for, and the Development of, a Reasonableness Test" (1974) 2:2 Queen's LJ 151 [observing the inherent difficulty involved in giving precise meaning to certain concepts contained in the Canadian Bill of Rights]; Jean Salmon, "Les notions a contenu variable en droit international public", in synthese", in Perelman & van der Elst, eds, *Les notions ad contenu variable en* (1984), translated and quoted in Olivier Corten, "The Notion of "Reasonable" in International Law: Legal Discourse, Reason and Contradictions" (1999) 48:3 The Int'l & Comp LQ 613 at 614. ["what characterizes notions such as reasonable is that they cannot be defined objectively"].

[254] See James Baldwin, "The Blind Men and the Elephant", *American Literature* (10 March 2019) online: https://americanliterature.com/author/james-baldwin/short-story/the-blind-men-and-the-elephant.

[255] "Blind Men and an Elephant Story", *BTC* (2021) online: https://perma.cc/TH33-YSBU.

way to respond would be to say that any taxing rights allocation compromise - or rule – that tends to render a state's tax base vulnerable to base erosion should be considered unreasonable. A state, as a rational actor, should not be expected to embrace such a compromise – not willingly. Still, I find myself back in positive framing, asking, for instance, "is it reasonable to insist that a non-resident entity must spend a minimum of 12 months earning income in a country before that country can tax the income"? Is this what makes the most sense? I do not think so; but even if you agree with me, this is just one constrained answer to a broader problem. What is required is a generic (but adaptable) test, rather than a response that only resolves one scenario of the broader problem.

Scholars, courts, and policymakers have grappled with the conundrum of "reasonableness" in various facets of legal application.[256] The term has been used to explain acceptable standards of conduct. Hence, we are often confronted with variations like a "reasonable man," "reasonable notice," "reasonable use," "reasonable force," "reasonable expectation," "reasonable care," "reasonable time", etc.[257] A standard of reasonableness has been applied to constitutional law,[258] sexual harassment law,[259] criminal law,[260] international law,[261] international investment

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[256] See, generally, Giorgio Bongiovanni, Giovanni Sartor & Chiara Valentini, eds, *Reasonableness and Law*, vol 86 (Cham: Springer, 2009).
[257] Michel Bobek, "Reasonableness in Administrative Law: A Comparative Reflection on Functional Equivalence", in G Bongiovanni, G Sartor & C Valentini, eds, *Reasonableness and Law*, vol 86 (Cham: Springer, 2009) 311.
[258] Daniel A Farber & John E Nowak, "Beyond the Roe Debate: Judicial Experience with the 1980's "Reasonableness" Test" (1990) 76:3 Va L Rev 519 [examining whether women have a right to an abortion subject to certain types of "reasonable" regulations]; Brandon L Garrett, "Constitutional Reasonableness" (2017) 102:1 Minn L Rev 61.
[259] Nancy S Ehrenreich, "Pluralist Myths and Powerless Men: The Ideology of Reasonableness in Sexual Harassment Law" (1990) 99:6 The Yale LJ 1177.
[260] Kwong-Leung Tang, "Battered Woman Syndrome Testimony in Canada: Its Development and Lingering Issues" (2003) 47:6 Int'l J Offender Therapy & Comp Criminology 618; Hisham M. Ramadan, "Reconstructing Reasonableness in Criminal Law: Moderate Jury Instructions Proposal" (2003) 29:2 J Legis 233; Kellie Toole, "Self-defence and the reasonable woman: Equality before the new Victorian law" (2012) 36:1 Mel Uni L Rev 250.
[261] Stephen R Tully, "'Objective Reasonableness' as a Standard for International Judicial Review" (2015) 6:3 J Int'l Dispute Settlement 546. The judgments and opinions of the ICJ contain various references to "reasonable" including one ruling by the court that insofar as possible, the limitation of maritime boundaries between states should allow the coasts of the states concerned to produce their effects, in terms of maritime entitlements, in "a reasonable and mutually balanced" manner. See, International Court of Justice, *Territorial and Maritime Dispute (Nicaragua v. Colombia)*,

arbitration,[262] human rights law,[263] torts law[264], administrative law (judicial review), and, not the least, international trade law.[265] In 2013, Graham Cook, then of the Legal Affairs Division of the WTO, observed that WTO law and jurisprudence contained more than 8,000 uses (including variants) of the term "reasonable".[266] The courts of common law countries like Canada, New Zealand, and the UK apply a reasonableness test to evaluate whether a public officer has exercised their administrative discretion in a manner that de-necessitates judicial intervention, regardless of whether the court would have come to a similar exercise of discretion.[267] In torts law, "reasonableness" has been a vital ingredient in the evaluation of liability for negligence.[268] It

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Judgment, 2012, para 215. The theme of this reference generally reflects respect for the primacy of the sovereignty of the states involved.

262 Kenneth J Vandevelde, "A Unified Theory of Fair and Equitable Treatment" (2010) 43 Int'l L & Pol 43:1 [to determine whether a host state's regulatory action against a foreign investor's interest does not violate the "fair and equitable treatment" principle that is common in bilateral investment treaty].

263 Fons Coomans, "Reviewing Implementation of Social and Economic Rights: An Assessment of the "Reasonableness" Test as Developed by the South African Constitutional Court" (2005) 65 ZaöRV 167 [Analysing a standard of review – reasonableness test – developed by the South African Constitutional Court for assessing compliance with constitutional obligations in the area of social and economic rights by the South African governmental authorities]; Brian Griffey, "The 'Reasonableness' Test: Assessing Violations of State Obligations under the Optional Protocol to the International Covenant on Economic, Social and Cultural Rights" (2011) 11:2 Human Rights L Rev 275; Cedric Ryngaert, "Jurisdiction: Towards a Reasonableness Test", in M Langford, ed, *Global Justice, State Duties: The Extraterritorial Scope of Economic, Social, and Cultural Rights in International Law* (Cambridge: University of Cambridge Press, 2013) 192 [applying general international law to delimit the jurisdictional scope of human rights treaties: i.e., which state(s) should exercise transnational jurisdiction to protect victims of (ecological, social, and cultural) rights violations suffered at the hands of MNCs].

264 Benjamin Zipursky, "Reasonableness In and Out of Negligence Law" (2015) 163:7 Uni Penn L Rev 2131.

265 Graham Cook, "Reasonableness in WTO Law" (2013) 1:2 Latin Am J Int'l Trade L 713.

266 *Ibid*.

267 See Timothy P Fadgen, Guy Charlton & Mark Kielsgard, "Narrowing the Scope of Judicial Review for Humanitarian Appeals of Deportation Orders in Canada, New Zealand and the United States" (2014) 35:2 Hamline J Pub L & Pol'y 240; Marcelo Rodriguez Ferrere, "Redefining Reasonableness" (2017) NZLJ 67; W John Hopkins, "The "Dreadful Truth" and Transparent Fictions: Deference in New Zealand Administrative Law", in G Zhu, ed, *Deference to the Administration in Judicial Review*, Ius Comparatum – Global Studies in Comparative Law, vol 39 (Cham: Springer, 2019) 345; David Mullan, "Reasonableness Review Post-Vavilov: An "Encomium for Correctness" or Deference as Usual?" (2021) 23:2 Can Lab & Emp LJ 189; Paul Daly, "Patent Unreasonableness after Vavilov" (2021) 34:2 Can J Admin L & Practice 167.

268 Steven P Croley, "Vicarious Liability in Tort: On the Sources and Limits of Employee Reasonableness" (1996) 69:5 S Cal L Rev 1705; Benjamin C Zipursky, "Reasonableness in and out of Negligence Law" (2015) 163:7 U Pa L Rev 2131.

assesses negligent behaviour on the scale of what a "reasonable man", in the same circumstances, would do.[269]

A "reasonable" test has also been applied in tax law discourse to examine potential shortfalls in a rule designed to address an aspect of international tax (in)efficiency,[270] as well as to examine issues of fairness in tax administration,[271] but to my knowledge, not yet to the often discordant subject of inter-national tax equity.

Although their contexts may differ, it seems to me that in many of these respects the application of reasonableness is aspirational: it aspires towards a position or outcome that is fair, sound, or moderate.[272] It does not imply that which is perfect, although perfection would not be deemed inimical to it. It is a fitting standard for a determination or judgment that ordinarily defies scientific precision, but is tied, more often than not, to the circumstances of each situation.[273] To borrow the words of the WTO Appellate Body when interpreting the term "reasonable period" in the context of Article 6.8 of the Anti-Dumping Agreement:

> The word 'reasonable' implies a degree of flexibility that involves consideration of all of the circumstances of a particular case. What is 'reasonable' in one set of circumstances may prove to be less than 'reasonable' in different circumstances. This suggests that what constitutes a reasonable period or a reasonable time, under Article 6.8 and Annex II of the *Anti-Dumping Agreement*, should be defined on a case-by-case basis, in the light of the specific circumstances of each investigation.[274]

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[269] Fleming James Jr., "The Qualities of the Reasonable Man in Negligence Cases" (1951) 16:1 Mo L Rev 1.
[270] Dennis Weber, "The Reasonableness Test of the Principal Purpose Test Rule in OECD BEPS Action 6 (Tax Treaty Abuse) versus the EU Principle of Legal Certainty and the EU Abuse of Law Case Law" (2017) 10:1 Erasmus LR 48.
[271] João Dácio de Souza Pereira Rolim, "The Role of the Rule of Reason, the Standard of Reasonableness and the Principle of Proportionality in Assessing Fair Taxation" (PhD Thesis, Queen Mary University, 2013).
[272] See Black's Law Dictionary, 11th ed at 1518, *sub verbo* "reasonable".
[273] The International Court of Justice (ICJ) has remarked that "what is reasonable and equitable in any given case must depend on its circumstances". See *Continental Shelf (Tunisia/Libyan Arab Jamahiriya),* Judgment [1982] ICJ Rep 18., para 72.
[274] *United States—Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan (Complaint by Japan)* (2001), WTO Doc DS184 (Appellate Body Report), para 84.

It is through this prism that I conceive "reasonable"; and I am convinced that such a flexible and functional approach fits with the subject of taxing rights allocation, since no countries – or class of countries – can pretend to conceptualize (never mind actualize) outcomes of perfection. The peak level that countries can aspire to is a fair outcome, a moderate outcome, or, more aptly, a reasonable outcome; and that 'reasonable outcome' must be adjudged, not in terms of how much countries receive – for it is they who give it up – but in terms of "how much tax jurisdiction is reasonable for a sovereign to concede in order to limit the distortionary effect of double taxation on international trade"? This functional conceptualization of reasonableness reflects the pattern that scholars have followed in both understanding and deploying the concept. For instance, Corten notes that the functions played by "reasonable" can be divided into two categories: "technical" and "ideological" functions.[275] Technical functions enable the legal system to work, while ideological functions mean that reasonable is used to the benefit of one particular actor in the legal system.[276]

As a technical functional concept, reasonableness embodies attributes of adaptability/flexibility. It displaces resort to the rigidity of legal texts. For instance, what constituted a reasonable threshold for a permanent establishment in the 1960s – a compromise threshold that source countries were, therefore, willing to accept – may not meet such standards in the 2000s considering the digital transformation of economic activities. Reasonableness is adaptable to such changes. While a legal test, such as a 180-day rule, may be too rigid to adapt to present realities, a reasonableness test would more easily supersede such rigidity. In an adjudicatory context, a reasonableness test would allow a judge to provide a reasoning in the absence of more precise criteria.[277] The same can be applied to a profit allocation framework, for instance. While there are no methodologies to

[275] Corten *supra* note 253 at 614–615.
[276] *Ibid.*
[277] *Ibid* at 616.

precisely determine the degree of activities that take place in an LIDC and the due reward for those activities, a methodology that best preserves or least impairs the taxing rights of that country may be adopted.

With regard to its ideological function, Corten remarks that the notion of "reasonable" should be analyzed with particular reference to the phenomenon of legitimisation.[278] He posits that "reasonable" is used in order to legitimise an assertion which is, by definition, subject to change.[279] Reasonable provides legitimacy to the international legal order as a whole, by presenting an image of a closed, coherent and complete legal system. References to reason portray an ideal of unity and community of values that is particularly remarkable in an international system which is very loosely integrated, and which is characterized by decentralized centres of power and acute cultural and political differences.[280] Thus, in an international order such as the international tax regime comprising states of divergent backgrounds, interests and distribution of power, reasonableness, in the context of taxing rights allocation, connotes an imperfect solution that regards the right to fiscal self-determination of states. It reflects "an agreement on the lack of agreement. Each State maintains its own conception of what is reasonable, and will exercise its powers according to that concept".[281] Such a compromise allows each state better autonomy to determine, for instance, the pivotal question of how much taxing rights that it can afford to surrender to fulfill its responsibility of contributing to an efficient international trade system. That determination is not imposed by states more powerful.

[278] *Ibid* at 618.
[279] *Ibid.*
[280] *Ibid.*
[281] *Ibid* at 619.

In the end, I have formulated a fragmented framework that gravitates towards this impulse of fiscal self-determination. I opine that, at this stage, what we should aspire to ascertain is whether, taking into account the entire circumstances of the compromise, including the economic status of states, the impairment of tax jurisdiction makes sense for the country(ies) involved. In order to establish whether a taxing right impairment is reasonable, several factors should be considered. These include: (1) the disparity of means factor, which generally assesses a state's capacity to give up taxing rights based on that state's overall revenue mobilization capacity; (2) the vitality factor, which bases the capacity to give up taxing rights on the relative importance of the specific tax base to the state; (3) the substantive reciprocity factor, which assesses whether there is actual reciprocity in the levels of taxing rights given up by compromising states; (4) the alternativity factor, which focuses on whether there is a less restrictive and, yet, efficient alternative(s) to the proposed or subsisting tax compromise; and (5) the non-tax benefits factor, which considers the scope for concrete non-tax benefits that are expected to flow (directly or indirectly) from the compromise. These factors may be considered severally, cumulatively, and contextually. Without further ado, I proceed to examine them.

2.3.3.1 Disparity of Means

This is a critical consideration as far as LIDCs are concerned. The contention here is simply that the international tax regime must not unduly suppress the tax jurisdiction of poorer countries. Put differently, we should not place heavy expectations on countries to concede taxing rights if to do so would hurt their revenue mobilization in a way that they can ill-afford.

International tax compromise has always been about giving up taxing rights. Therefore, the question of what/how much countries can afford to give-up is both implicit and imperative. It has been so from the initial compromise. Incidentally, during the nascent years of the double taxation

regime the issue was largely framed in terms of "who (between residence and source countries) should give up taxing rights."[282] Thus, at the end of the bargain, residence countries were asked to give up taxing rights over certain kinds of income while source countries were asked to give up taxing rights over other kinds of income. The distributional lopsidedness that ensued from that framing is well documented.[283]

Assuming instead that the fundamental question of double tax relief is also framed in terms "who CAN AFFORD to give up taxing rights" rather than just "who should give up taxing rights", I am of the view that the response could result in a more nuanced and, frankly, more equitable surrender of taxing rights. The approach that was taken was, instead, over-generalized, applying the same rules to all residence countries and the same rules to all source countries, so to speak. Some countries are predominantly source countries, while some may be predominantly residence countries. Yet, some countries may be a complex mix of residence and source. This is certainly the case for the capital-importing countries of continental Europe who soon found themselves as capital exporting countries when engaging with non-European LIDCs.[284] In the same vein, not all "developing countries" are in the same league. It has been noted, for instance, that "developing states" is a very heterogenous group including BRICS countries and least developed countries, at opposing ends of economic power. Therefore, it may not be ideal to focus on the BRICS countries as representatives of the developing world.[285] A nuanced approach has the potential to better reflect the disparity of means between individual countries (or class of countries) – that is, to reflect the respective capacity of countries to give up taxing rights.

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[282] 1923 Report *supra* note 144.

[283] For instance, Tsilly Dagan, "The Tax Treaties Myth", (2000) 32:4 NYU J. Int'l L & Politics 939; Braun *supra* note 16; Brooks & Krever *supra* note 17.

[284] Genschel & Rixen *supra* note 110.

[285] See Veronika Daurer, *Tax Treaties and Developing Countries* (Alphen aan den Rijn: Kluwer Law International, 2014) cited in Emblad *supra* note 15 at 8.

Depending on the circumstances, a country with low per capita income[286] or low GNI[287] or even low untaxed GDP[288] may have less capacity to give up taxing rights than one with higher figures in any of these metrics. Therefore, it might be relatively unreasonable to expect such a country to give up much of its taxing rights, regardless of whether it is a predominantly residence or predominantly source country.

The disparity of means approach mirrors the principle of "common but differentiated responsibility" articulated, in an international tax context, by Ivan Ozai to support a fair distribution of the consequential burdens of ending international tax competition.[289] Ozai advocates a similar approach to that adopted by the international community in tackling the common problem of climate change. Although there is consensus that all states should contribute to combating climate change, reasons of "justice and political feasibility" also compel states to equitably distribute the levels of contribution that each state must make towards reducing greenhouse gas emissions.[290] This concept of "common but differentiated responsibility" (CBDR) is entrenched in the language of the 2015 Paris Agreement[291] and has been justified on several grounds, mainly that HIDCs bear overwhelming historical responsibility for benefits and damages ensuing from past emissions[292] and that HIDCs simply have greater ability to pay for greenhouse caps than LIDCs.[293]

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[286] Musgrave & Musgrave *supra* note 8.
[287] Infanti *supra* note 27.
[288] Rosenzweig *supra* note 61.
[289] Ozai "Tax Competition and the Ethics of Burden Sharing" *supra* note 198.
[290] *Ibid* at 80.
[291] United Nations, *Paris Agreement* (New York: United Nations, 2015) at 1 ["The Parties to this Agreement… recognizing the specific needs and special circumstances of developing country Parties"] and at 3 ["this Agreement will be implemented to reflect equity and the principle of common but differentiated responsibilities and respective capabilities, in the light of different national circumstances."].
[292] See Kok-Chor Tan, *What Is This Thing Called Global Justice?* (2017) at 120 and 127–128 (advancing both the "polluter pays principle" and the "beneficiary principle").
[293] Darrel Moellendorf, *The Moral Challenge of Dangerous Climate Change* (Cambridge University Press, 2014). Although there is some temptation to reference apparent historical injustices in global taxing rights distribution as a

For our purpose, disparity of means, mirroring CBDR, accepts the view that double taxation is a common international problem but argues further that countries' obligation to contribute to solving that problem should closely reflect their respective capacities to surrender taxing rights. A one-size-fits-all solution that causes LIDCs to "equally" surrender domestic revenue mobilization capacity will only aggravate the endemic problems that necessitate and perpetuate global (substantially) humanitarian programs like the SDGs (before that Millennium Development Goals).

Importantly, the argument here is that the international tax regime should shield the tax base of LIDCs from inordinate artificial restriction and countries should, therefore, as much as possible avoid international tax norms that unduly constrain the rights of LIDCs to tax income that they are ordinarily entitled to tax. International tax compromises, including tax treaties, should take into account the wealth disparity between participating countries when setting restrictions on the exercise of tax jurisdiction.

One handy way to illustrate the disparity of means test is to examine the restrictions on source taxation of business profits. I earlier outlined the various forms of economic activity that are excluded from the permanent establishment definition, which means that a source country cannot tax income arising from such activities regardless of the revenue outflows. A notable example is the exclusion of facilities and activities relative to the distribution of goods. This kind of restriction allows a non-resident entity to carry out significant storage and distribution activities in a source country without paying any taxes on the income derived from those activities. While HIDCs may be able to stomach such revenue losses due to their broader tax bases, the same cannot be said of

basis for a "disparity of means" approach to prospective international taxing rights compromise, I am solely focused on the "ability to pay" notion. This aligns with the view that states with lesser means should be less expected to surrender taxing rights.

LIDCs. Perhaps, a more reasonable approach would allow the source country to impose some tax on distribution activities of significant value, in order to ameliorate the erosion of its tax base.[294]

We can further articulate this test by examining the taxation of royalties under Article 12 of both the OECD MTC and the United Nations Model Double Taxation Convention between Developed and Developing Countries (UNMTC).[295] Even the most recent version of the OECD MTC (2017) remains consistent in exclusively reserving the right to tax cross-border royalty payments to the country of residence of the beneficial owner of the payments.[296]

A "royalty" is a payment made to the owner of intangible property for the right to use or exploit that property.[297] Article 12(3) of the UNMTC defines "royalties" as:

> payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience.[298]

To state generally, the items captured in the UNMTC definition of royalties include: payments for the use of copyright; payments for the use of patent, trademark, design or model, plan, secret formula or process; payments for the use of industrial, commercial or scientific equipment; and payments for information concerning industrial, commercial or scientific experience.

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[294] I do not dwell on this conversation at this point because of chapter 3 which addresses tax challenges arising from the digitalization of the economy.
[295] United Nations Department of Economic & Social Affairs, *Model Double Taxation Convention between Developed and Developing Countries*, ST/ESA/378 (September 2021).
[296] OECD MTC, Article 12(1).
[297] Brooks & Krever *supra* note 17 at 172.
[298] A bit more narrowly, Article 12(2) of the OECD MTC defines "royalties" as: "payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience".

The rights identified in the definition are commonly referred to as "intangibles,"[299] "intellectual property,"[300] or intellectual property rights,[301] and are recognized and protected by intellectual property laws.[302] This reality makes references to intellectual property literature highly relevant to the definition of royalty and its affiliate terms. It also means that our understanding of the kinds of payment that are within the scope of royalty would be enhanced by appreciating the things that are defined and protected by intellectual property law. If a thing is defined and protected by intellectual property law – whether in the form of copyright, patent, trademark, or know-how – then it makes sense to infer that a payment that is made for the license to "use" that thing, in a manner that only the owner of the right would, is a royalty.[303]

The position, in the OECD MTC, to make taxation of royalties an exclusive right of the residence country is a consequence of the compromises reached in the initial formation of the international tax regime, particularly, the framework of tax treaties, where it was determined that passive income should be taxed at residence, while active income should be taxed at source, upon the existence of

[299] "Intangibles" is a term that is often used alternatively with IP in international tax parlance. Chapter VI, paragraph 6.6 of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations defines "intangible" as "something (i) which is not a physical or a financial asset; (ii) which is capable of being owned or controlled for use in commercial activities, and (iii) whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances". The Guideline also provides an open list of what can be considered an intangible asset for transfer pricing purposes. This list includes patents, know-how and trade secrets, trademarks, trade names and brands, rights under contracts and government licenses, licenses and similar rights in intangibles, goodwill, and ongoing concern value. See Dulce Miranda, "Definition and Identification of Intangibles" in B Heidecke, *et al,* eds, *Intangibles in the World of Transfer Pricing: Identifying - Valuing - Implementing* (Cham, Switzerland: Springer, 2021) 3 at 4.

[300] The World Intellectual Property Organization (WIPO) defines "intellectual property" as "creations of the mind, such as inventions; literary and artistic works; designs; and symbols, names and images used in commerce". See: https://www.wipo.int/about-ip/en/.

[301] See Meenu Chopra, "Tax on Intellectual Property Rights" (2019) 5:4 History Res J 1308.

[302] IP laws consist of mainly national legislation and a number of (ratified) international treaties such as the Hague Agreement Concerning the International Registration of Industrial Designs, 1925 and the Patent Law Treaty, 2000.

[303] In another sense, the protection concept can also enhance our appreciation of a source country's taxing rights claim. The protection accorded by a source country's legal system is a benefit to the IP owner. This protection gives the IP owner the assurance that users will pay to use its IP, and that the IP owner can have recourse to the source country's legal system should a user exploit their IP without obtaining the required license or title from the IP owner. This protection offers some justification for the (withholding) tax that a source country charges on royalty payments.

a permanent establishment.[304] Although that extreme restriction of source taxation subsists in the OECD MTC, it does not wholly reflect the practice of many states, as there seems to be an increasing recognition that such outright restriction is neither tenable nor fair, especially in the case of LIDCs.[305] This position holds especially true for LIDCs because of the potential impact on domestic revenue mobilization. Not only do royalty payments pose a significant base erosion risk for countries because of the premium price of intangibles and the deductibility of outbound payments,[306] an exclusive source taxation principle is especially bad for LIDCs because, as available data also shows, a disproportionately high volume of global payments for the use of intangibles goes to HIDCs.[307] This is not surprising considering the disparate capacities of HIDCs and LIDCs to develop and license intellectual property.[308] What this also entails is that the only material opportunity that LIDCs have to tax significant portions of royalties would be nullified if they were to strictly adopt the OECD framework. Suffice it to state that such a policy would produce what might be considered unreasonable revenue outcomes for LIDCs. It is, therefore,

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[304] See, generally, Wang *supra* note 145.

[305] See Kim Brooks, "Canada's Evolving Tax Treaty Policy toward Low-Income Countries" in AJ Cockfield, ed, *Globalization and the Impact of Tax on International Investments: Essays in Honour of Alex Easson* (Toronto: University of Toronto Press, 2010) 189 [demonstrating how Canada's tax treaty policy towards source taxation of royalties by low-income countries deviates from the restrictive OECD MTC recommendation]; Patricia Brown, "How Hard Can This Be? The Dearth of U.S. Tax Treaties with Latin America" (2020) 74:2 Uni Miami L Rev 359 [spotlighting how many tax treaties between HIDCs and LIDCs deviate from the restrictive intent of the OECD MTC].

[306] See Brian Arnold & Adolfo Martin Jimenez, "Protecting the Tax Base of Developing Countries against Base-eroding Payments: Rent and Royalties" (New York: United Nations, 2013). A significant portion of the current work on international tax reform is aimed at tackling base erosion that arises from royalty payments, especially between related entities. See, e.g., Katharina Finke, *et al,* "Extending Taxation of Interest and Royalty Income at Source – An Option to Limit Base Erosion and Profit Shifting?" (2014) ZEW Discussion Paper No. 14-073; Gregory Pun, "Base Erosion and Profit Shifting: How Corporations Use Transfer Pricing to Avoid Taxation" (2017) 40:2 B C Int'l & Comp L Rev 287; Małgorzata Kutera, "A Model of Aggressive Tax Optimization with the Use of Royalties" (2017) 30:4 J Econs & Mgt 86; Steffen Juranek, Dirk Schindler & Guttorm Schjelderup, "Transfer Pricing Regulation and Taxation of Royalty Payments" (2018) 20 J Pub Econ Theory 67; Madelein M Kleyn, "BEPS Project and Intangibles: Impact on IP Tax Structures" (2018) 53:2 J Licensing Exec Society 148.

[307] See World Bank, "Charges for the Use of Intellectual Property, Receipts (BoP, current US$)" online: https://data.worldbank.org/indicator/BX.GSR.ROYL.CD. [In 2020, for instance, while high income countries received approximately $374 Billion in royalty payments, other countries, ranked from low to upper middle income, received roughly a combined $40 Billion.]

[308] See "High Tech Exports – Country Rankings", *The Global Economy* (2020) online: https://perma.cc/2Y6N-PU5M.

encouraging that the UNMTC provides a treaty framework that is less restrictive on LIDCs ability to tax outbound royalty payments.

Since the UNMTC, as well as many tax treaties now accommodate LIDCs' source taxation of royalties, contemporary debate on the subject is no longer about whether LIDCs should tax royalties at source but about the extent to which they should, both in terms of what is covered and the rate of withholding tax that they should impose.[309] In terms of coverage, the conversation is essentially about whether to add to the items adumbrated in Article 12(3) UNMTC or to expand their meanings, where such potential exists, to broaden the scope for source taxation by LIDCs. After all, if they are so willing, countries can negotiate a broader or narrower definition of royalties for their tax treaties; and some do.[310]

Definitions have consequences. If a definition that is narrower than what is prescribed in the model convention is adopted, the implication is that certain payments for intangibles which would ordinarily qualify as "royalty" may not be covered.[311] Such payments may instead be characterized as "business profits" under Article 7. This classification may be problematic for the DRM objectives of LIDCs because the country of residence enjoys exclusive right to tax business profits,

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[309] Article 12(1) UNMTC currently envisages a singular and limited tax rate where the royalty is paid to a non-resident beneficial owner. However, for efficiency reasons, there is no anticipated tax rate limit if the beneficial owner of the payment is a resident of the source country. The source country can simply deal with the payment as it would do under domestic law.

[310] An example is Australia, which includes as "royalty" any amount paid for the supply of any assistance that is ancillary to, and furnished as a means of enabling the application or enjoyment of a copyright, patent, know-how, trademark, etc. Australia's definition of royalty also includes payment for "any like property or right" an expansion on the content of the OECD MTC and UNMTC definitions. See Income Tax Assessment Act 1936, section 6.

[311] In the Spanish Colgate-Palmolive case (2020), the Spanish Supreme Court declined any reference to "beneficial owner" in the interpretation of the Spain-Switzerland tax treaty (1967) because the concept is not mentioned in the treaty. The Court reasoned that the beneficial ownership concept cannot be construed by resorting to the OECD Commentaries, because soft law documentation cannot supersede the content of an applicable tax treaty. See Aitor Navarro, "The Relevance of the Beneficial Ownership Concept in Tax Treaty Clauses That Do Not Include It in Their Wording: A Note on the Colgate-Palmolive Case", *SSRN* (2021) online: https://perma.cc/RT28-XJ4N.

unless the "profits" are derived through a permanent establishment in the source country.[312] The implication is that certain payments may wholly escape taxation at source when they could be captured by a broader definition of royalty. A good example, one that has been the subject of recent debate, is payments for the use of (computer) software.

Paragraph 12.1 of the OECD commentary describes a software as:

> [a] program, or series of programs, containing instructions for a computer required either for the operational processes of the computer itself (operational software) or for the accomplishment of other tasks (application software). It can be transferred through a variety of media, for example in writing or electronically, on a magnetic tape or disk, or on a laser disk or CD-Rom. It may be standardised with a wide range of applications or be tailor-made for single users. It can be transferred as an integral part of computer hardware or in an independent form available for use on a variety of hardware.

The term "software" or "computer software" is not yet included in the definition of "royalties" in either the OECD MTC or the UNMTC. However, considering the market significance of software in today's global economy, it seems reasonable for source countries, especially LIDCs, to want to tax outbound payments for the use of software as royalties.[313]

If countries are to include payments for the use of computer software as royalties, so that they can tax at source, there are two approaches to inclusion, and each of these approaches has implications that are based on reliance on intellectual property law standards. One approach is to include software as a form of "artistic, scientific or literary work" in which case only compensation for the

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[312] UNMTC, Article 7. For a broader analysis of classification conflicts and concerns of overlap regarding the "royalties" clause and the "business profits" clause in the OECD/UN model conventions, see Adolfo Martín Jiménez, "Article 12 OECD/UN Models: Definition of Royalties and "Overlapping" between Articles 7, 12 and 13" in G Maisto, ed, *Taxation of Intellectual Property under Domestic Law, EU Law and Tax Treaties* (Amsterdam: IBFD Publications, 2018) 117.

[313] The global market for software products is estimated at just under $1 Billion, and it is still growing. See "Software Products Global Market Report 2021: COVID-19 Impact and Recovery to 2030 - ResearchAndMarkets.com", *Business Wire* (9 September 2021) online: https://perma.cc/Y6QR-Y7JJ; Although it is not clear how much of it is directly attributable to software, another survey estimates the global trade in "ICT goods" at over $2.3 trillion in 2020. Trade volumes grew by over 4% during this period, largely benefitting from COVID-19 pandemic and the increasing reliance on ICT tools. See UNCTAD, "Pandemic Drives ICT Goods Trade Rebound but Steep Declines Occur in Least Developed Countries and Africa" (2 November 2021) online: https://perma.cc/N9N9-6N9F.

"use" of a software copyright can qualify as royalties. The other approach is to include software as a patent or *sui generis* (same as things like patent, trademark, design, plan, secret formula, etc.), in which case the (technical) "use" requirement, which is a major barrier to source country taxation, is sidestepped.

The Commentary of the UNMTC observes that "the copyright laws of many countries deal with this problem by specifically classifying software as a literary or scientific work".[314] The BEPS Monitoring Group also observes that as many as 600 tax treaties include "software" in their definition of royalties.[315] Most of these treaties, however, regard "computer software" as a species of "artistic, scientific, or literary work".[316]

A *sui generis*, less common, approach to software inclusion in the definition of royalties can be found in the India-Russia tax treaty which lists "computer software" (detached from copyright) alongside things like trademark, patent, know-how, and secret formula, as a property that is eligible for royalty payment.[317] This suggests that computer software stands on its own in the class of things that intellectual property law, generally, protects and, in terms of tax consequences, implies that payments for the use of computer software may amount to royalties even without the kinds of "use" that copyright use contemplates (e.g., reproduction, modification, and distribution).[318]

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[314] UNMTC, Commentary to Article 12, para 12 quoting para 13.1 OECD MTC Commentary to Article 12.
[315] The BEPS Monitoring Group, "Inclusion of Software Payments in the Royalties Article of the UN Model Convention" (6 October 2020) online: https://perma.cc/B3RH-W8KQ.
[316] An example is Paragraph 12(3)(a) of the India-Romania tax treaty which places software within the cluster of things that are subject to copyright protection.
[317] Article 12(3)(a) of the India-Russia tax treaty.
[318] Copyright law recognizes a general right to use computer software as an end user. This is distinct from the right to exploit the copyright in a computer software by, for instance, reproducing or modifying the software for distribution. Currently, the answer to the question of how payment for computer software should be treated depends largely on whether the right granted by the software owner to the "user" is a mere right to use the software product, as an end user, or a right to exploit the underlying copyright in the software, in which case the user can (with some contractual limits) deal with the software in a manner that only the copyright owner legally could, e.g., reproducing, revising, distributing, displaying, or selling copies of the software. See, generally, Ganesh Rajgopalan, "United Nations Model Tax Convention - Proposed Inclusion of Software in the Definition of Royalties in Article 12: Comments on the 2020 Discussion Draft", *SSRN* (2020) online: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3715609; Nurul

Evidence from individual state practices and international consensus buttresses the status of software as intellectual property that should be accorded legal protection,[319] with copyright as the main form of protection. The OECD MTC commentary notes at paragraph 12.2 that:

> The rights in computer programs are a form of intellectual property. Research into the practices of OECD member countries has established that all but one protects rights in computer programs either explicitly or implicitly under copyright law.

This "consensus" is further reflected in the WTO Agreement on Trade Related Aspects of Intellectual Property (TRIPS) – the minimum standard international scheme for IP protection – which explicitly protects computer software as "literary work".[320] However, TRIPS only protects the source and object codes of a software, and leaves computer behavior to the realm of (domestic) patent law.[321]

The commentary of the OECD MTC (quoted in the UNMTC commentary), contains various technical explanations about the tax treatment of payments for the use of software (usually as either business profits or royalties) depending on how the software is used. The commentary mainly sets out instances where payments for the use of software do not amount to royalties. This includes payments made by an intermediary distributor to a copyright owner for the right to distribute copies of the software program (without the right to reproduce or modify the software).[322] Such payments would be treated as business profits, and not royalties.[323]

Hulwanita Sharfina, *et al,* "Copyright Issues on the Prank Video on the YouTube" (2021) 583 Advances in Soc Sc, Edu & Humanities Res 90.

[319] See Matthew K McGowan, Paul Stephens & Dexter Gruber, "An Exploration of the Ideologies of Software Intellectual Property: The Impact on Ethical Decision Making" (2007) 73:4 J Bus Ethics 409.

[320] WTO TRIPS, article 10.

[321] Aaron D Charfoos, "How Far Have We Come, And Where Do We Go from Here: The Status Of Global Computer Software Protection Under The TRIPS Agreement" (2002) 22:2 Northwestern J Int'l L & Bus 261.

[322] UNMTC, Commentary to Article 12, para 12, quoting OECD MTC Commentary to Article 12, para 14.4.

[323] *Ibid.* This interpretation follows the technical reality that in such transactions, distributors are paying only for the acquisition of the software copies and not for the right to exploit the underlying software copyrights.

The limitation that allows payments for the right to distribute software products to entirely escape source country taxation aligns with the general recognition of software ownership as a copyright only. This is notwithstanding the longstanding debate over whether computer software can also be registered – and protected – as a patent.[324] Historically, software companies have sought "double protection" of their products against potential infringement by securing both copyright and patent registration[325] and there are instances where patent protection has been granted.[326] A copyright provides an exclusive right to reproduce, revise, distribute, display, or sell published material.[327] A copyright, thus, protects published versions of software.[328] However, because software developers view their products as more than a publishable idea, they have also sought the issuance of patents to protect the codes and systems inherent in software programs.[329] A patent is a right to exclude others from making, importing, using, keeping, offering to dispose a patented process or the product of a patented process without authorization.[330]

Unlike a copyright use, a patent use does not require the reproduction/modification element. Mere distribution of the patented material would qualify as "use", which implies that payments for the right to distribute a patented software would qualify as royalties, and, therefore, taxable at source. Such an approach would soften the restriction on the right of source countries to tax payments made to non-resident software owners for the right to distribute. It is in that spirit that the UN Tax

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[324] See Andrés Guadamuz González "The Software Patent Debate" (2006) 1:3 J L & Practice 196.
[325] Laurence Barton & Yogesh Malhotra, "International infringement of Software as Intellectual Property" (1993) 93:8 Industrial Mgt & Data Systems 20.
[326] Daniel Closa, *et al, Patent Law for Computer Scientists: Steps to Protect Computer-Invented Inventions* (Springer, 2010) [examining the "software" patent protection practices of the U.S., Europe, and Japan].
[327] Barton & Malhotra *supra* note 325.
[328] *Ibid.*
[329] *Ibid.*
[330] Duncan Spiers, *Intellectual Property Law* (Dundee: Dundee University Press, 8th ed, 2009) at 49. The main policy arguments against patent protection are that it would stifle competition and innovation in software development. See Closa *supra* note 326; Grant C. Yang, "The Continuing Debate of Software Patents and the Open Source Movement" (2005) 13:2 Tex Intell Prop LJ 171 [countering that line of argument].

Committee has recently explored the possibility of expanding the definition of royalties to include payments for the use of software that do not entail the use of copyright.[331] Although the option explored by the UN Tax Committee deviates from the traditional software = copyright position, it does have the potential to rectify the current position that does not allow LIDCs to tax various forms of software payment (including commercial distribution). It gives cause for a deeper consideration of the reasonableness of the restrictions imposed by the current regime on the taxing rights of LIDCs as net technology importing countries. Such countries, due to their limited means of domestic revenue mobilization, have less capacity to surrender the right to tax cross-border payments for software, and other forms of intellectual property, however classified. Ultimately, regardless of whether software is construed as copyright protected or patent protected, the bottom-line is that LIDCs retain a prime fiscal interest in the distribution/sale of software in their territory. The exclusion of income from such activities potentially borders on unreasonableness, depending on the scope for revenue loss that subsists in each case.

The point here is that while countries are generally expected to surrender their taxing rights in order to facilitate a thriving global trade system, some countries can less afford wholesale concessions of taxing rights. Countries with smaller tax bases and greater revenue/developmental needs should not be expected to give up taxing rights in a way that depletes their capacity for domestic revenue mobilization. We must systematically consider the revenue concession capacity of such countries in framing international taxing rights allocation rules.

[331] UN Committee of Experts on International Cooperation in Tax Matters, *Update of the UN Model Double Taxation Convention between Developed and Developing Countries – Inclusion of software payments in the definition of royalties* (New York: United Nations, 2020).

2.3.3.2 Vitality

The vitality factor holds that when setting limits to the exercise of international tax jurisdiction, countries should aim to avoid restrictions that may excessively impact tax types that are crucial to their revenue bottom-line. If a country's domestic revenue mobilization depends heavily on a particular income yielding activity, industry, or tax stream, it would seem unreasonable to expect that country to embrace an international tax compromise that significantly impairs its ability to tax that activity or impose that kind of tax. This may be particularly important for sector specific tax arrangements but also general compromises that target specific kinds of tax (in the schedular approach). As a generic example, it might seem unreasonable to expect a country whose main engagement with international trade is that it controls a major international shipping port, but which owns no vessels, to forgo source taxation of international shipping in favor of residence taxation. It might, likewise, seem unreasonable to expect a country like Canada to embrace a compromise that significantly restricts source taxation of income earned by non-residents from real property, considering that the real property market is a huge chunk of Canada's GDP.[332] Such a compromise has the potential for colossal base erosion.[333]

African countries are well known to heavily depend on corporate taxes, unlike their, say, OECD counterparts that have diverse sources of tax revenue, such as personal income taxes and

[332] Statista, "Canada: Gross Domestic Product (GDP) 2021, by industry" (30 September 2021) online: https://www.statista.com/statistics/594293/gross-domestic-product-of-canada-by-industry-monthly/.

[333] Such a result is more likely if there is significant foreign ownership of real property.

consumption taxes.[334] The corporate tax is crucial for developing countries where it "frequently amounts to over twenty-five percent of total revenues".[335] As Hearson observes:

> Developing countries have much lower per capita national incomes than developed countries, but they also convert a much smaller percentage of that income into government revenue... This means that taxation raised from multinational companies and wealthy individuals is more precious to them than it is to developed countries, hence the focus of so much attention from development campaigners in recent years on the avoidance and evasion of such taxes.[336]

A tax compromise that significantly impairs a country's jurisdiction to tax the income of corporations earned in its territory may be deemed unreasonable to countries that are heavily dependent on corporate taxes, even though it may be less so for countries with viable alternatives.

Also, resource rich countries might consider how tax treaties limit their capacity to tax income derived from the extraction of natural resources. A more reasonable approach would entail insulating taxation of the relevant sector from excessive impairment that may be occasioned by a compromise. In this specific case, a reasonable way to deal with the problem might be to adopt the Musgraves' national rental principle which allows resource rich but capital poor countries to charge a huge rental value – outside the tax system – on the extraction of their natural resources.[337] However, as a matter of general principle, countries may consider unreasonable and, therefore, strive to avoid tax compromises that make it harder for them to tax income types that they deem vital to their fiscal needs.

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[334] See Richard M Bird & Eric M Zolt, "Redistribution via Taxation: The Limited Role of the Personal Income Tax in Developing Countries" (2005) 52 UCLA L Rev 1627 at 1656; Ernesto Crivelli, Ruud De Mooij & Michael Keen, *Base Erosion and Profit Shifting and Developing Countries* (2015) IMF WP/15/118; Reuven S Avi-Yonah, "Hanging Together: A Multilateral Approach to Taxing Multinationals" (2016) Mich Bus & Entrepreneurial L Rev 137 at 139; Durst *supra* note 20.

[335] Avi-Yonah, *ibid.*

[336] Martin Hearson, "The Challenges for Developing Countries in International Tax Justice" (2018) 54:10 The J Dev Stud 1932 at 1933.

[337] Musgrave & Musgrave *supra* note 8.

2.3.3.3 Substantive (or Contextual) Reciprocity

We can examine the reasonableness question from a contextual angle of reciprocity. Because a compromise is a give-and-take affair, a reasonable compromise would aim to achieve some level of substantively equal giving – or taking – between parties. Reciprocity is an important international tax principle, particularly as regards the imposition of withholding taxes on investment income earned by residents of a treaty partner.[338] According to Peggy Musgrave, reciprocity requires that each pair of jurisdictions should tax the income earned by residents of the other at equal rates and contrasts with the more generally applied rule of non-discrimination, which requires that each jurisdiction tax the income earned by investors from abroad at the same rate that income accruing to domestic investors is taxed.[339] This also means that in the particular case of business profits taxation the withholding tax that is imposed on dividends is independent of the corporate tax rate applied to the underlying business profits.[340]

We may refer to the kind of reciprocity envisaged above as formal reciprocity. This form of reciprocity hinges on the textually or numerically equal restriction of the withholding tax rate that each country may impose on investment income earned residents of the other. A tax treaty between France and the UK will be deemed formally reciprocal if the countries agree to include an identical restriction on the rates of withholding tax on dividends, interest, or royalties. In the case of interest, for instance, Article 11(1) of the France-UK DTT specifies that "interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State".[341] The

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[338] Musgrave, "Interjurisdictional Equity", *supra* note 173 at 53. ["A limited reciprocity rule has, generally, been adopted in a number of international tax treaties whereby withholding taxes are applied at equal rates by each treaty partner to investment income but this rule has not been applicable to income taxes at source."]

[339] *Ibid.*

[340] Hugh J Ault, "Corporate Integration, Tax Treaties and the Division of the International Tax Base: Principles and Practices" (1992) 47:3 Tax L Rev 565 at 576.

[341] France - United Kingdom: 2008 Income and Capital Gains Tax Convention and Final Protocol, Article 11(1).

treaty exclusively reserves the right to tax interest payments for the country of residence of the recipient, meaning that neither country can impose any form of tax on interest payments at source.[342] In this case there is formal reciprocity because, on the face of it, the restriction on source taxation applies to both countries. It is not a case of only one country taxing, while the other does not.

We can also analyze the issue from the angle of substantive or contextual reciprocity. This kind of reciprocity looks beyond the text of the treaty and considers the capital export capacity or investment flows between the two countries. In the case of capitally 'equal' countries or in a case where there is relatively symmetric investment flows, neither country would be too concerned about giving up source taxation since they can compensate for that concession by taxing similar inflows of interest (or other kind of investment income) to their residents investing in the other country.[343] So, in the above example, even though France and the UK both surrender the right to tax interest payments at source, they can make up for this sacrifice by taxing interest payments received by their residents who export debt capital to the other country. We are likely to see this relatively balanced outcome because they are both capital exporting countries and are, presumably, capitally equal countries.

However, where we have an asymmetric relationship, such as in a treaty between a capital rich and a capital poor country, the substantive results, in terms of tax revenue, are likely to look quite

[342] This restriction of source taxation is even more severe than what is contained in the OECD MTC which provides that: "interest arising in a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation". Article 11(2) OECD MTC. Another example, the Austria-Switzerland DTT completely excludes source taxation of interest and royalties. Austria - Switzerland: 1974 Income and Capital Tax Convention, as amended through 2012 (English Translation), Articles 11 & 12.
[343] See Ring, "International Tax Relations" *supra* note 2 at 123.

different.[344] The absence of capital export symmetry makes it unlikely that residents of the capital poor country would have commensurate debt investments in the capital rich country to derive interest payments that the capital poor country can tax (to compensate for the source taxing rights that it surrenders). What this means, in practice, is that the only opportunity for the capital poor country to tax interest payments is at source, while the capital rich country can tax both on the basis of residence and source. In other words, formal reciprocity is unlikely to translate to substantive reciprocity. This is because while a treaty-based (total or partial) restriction of source taxation may be formally reciprocal, the circumstances of the two countries makes such restrictions non-reciprocal. From a tax perspective, the restriction only truly affects the capital poor country.[345] This is why it makes sense to approach reciprocity contextually rather than just formally.

One way to address the potential distributional lopsidedness arising from asymmetric relations is to adopt non-reciprocal withholding tax rates. First, it means that exclusive residence taxation is not a reasonable option, at least not for the LIDC. Second, it entails "allowing" the LIDC to impose withholding taxes at a higher rate than the HIDC, to balance out tax revenues arising from the uneven interest (dividend, royalty, etc.) outflows. The Musgraves, decades ago, championed the incorporation of this kind of fairer distribution mechanism into the international tax regime.[346]

[344] Thornton Matheson, Victoria Perry & Chandara Veung, "Territorial vs. Worldwide Corporate Taxation: Implications for Developing Countries" (2013) IMF WP/13/205 at 3 ["the historical framework for cross border income tax arrangements, which began to evolve in the early twentieth century to handle income flows between advanced economies, appears increasingly poorly suited to allow low-income countries effectively to generate tax revenues from profits on foreign direct investment"]. An implicit example is the tax treaty between Switzerland and South Africa which restricts source taxation of interest payments to 5% and outright excludes source taxation of royalties. South Africa - Switzerland: 2007 Income Tax Convention and Final Protocol, Article 11(2) & Article 12(1) respectively.

[345] This analysis applies with equal force to a treaty provision that does not outright bar source taxation of investment income but rather places equal percentile limits on the rate of withholding taxes that either country may apply at source.

[346] Musgrave & Musgrave *supra* note 8 at 74.

Some countries have, to some extent, embraced such policies.[347] It is a mistake to portray such measures in the language of tax aid.[348] Perhaps, such a policy should be regarded as preservative or curative. It ameliorates the lopsidedness in taxing rights restrictions which inhere in asymmetrical relations.[349] It is also about preserving the source taxing rights of LIDCs, as discussed above. There is no "aid" involved, since the LIDC was already entitled to tax the interest, based on the source rules, but was prevented from doing so by the artificial barriers of the tax treaty.[350]

In evaluating the fairness of international tax compromises, especially those contained in bilateral tax treaties, we may consider whether there is substantive reciprocity in terms of the impairment that each country submits to. This is particularly relevant in the case of a HIDC-LIDC compromises. What appears to be reciprocal on the surface may not constitute real reciprocity when one digs deeper. Where the arrangement points to one country – especially the LIDC – giving up more than it receives, in a tax sense, then we may be inclined to infer that the arrangement is not "really reciprocal" and therefore unreasonable.

2.3.3.4 Alternativity

Another way to assess the reasonableness of an international tax compromise is to consider whether there are alternative measures or formats of compromise that are efficient but less

[347] For instance, Article 12(2)(b) of the Algeria-France DTT which allows Algeria to tax certain royalty payments at 12% while France can only tax at 10% (both at source). The Cameroon-Canada Tax Treaty is a great example. It allows Canada to tax interest, dividend, or royalty payments flowing from Canada to a resident of Cameroon at a withholding tax rate of 15% each while at the same time allowing Cameroon to tax the same classes of income at 20%.
[348] See Falcão, "Inter-nation Equity", *supra* note 54.
[349] This is perhaps why some tax scholarship disputes the policy soundness of worldwide income taxation by countries of residence in asymmetrical situations, considering that this system was conceived to fit relations between countries with symmetrical flows of capital. See Dimitri Paolini, Pasquale Pistone, Giuseppe Pulina & Martin Zagler, "Tax Treaties with Developing Countries and the Allocation of Taxing Rights" (2016) 42:3 Eur JL Econ 383.
[350] Such an outcome may also reflect the renewed ability of countries to achieve better negotiated bargains about their own taxing jurisdiction and the degree to which they are willing to cede it.

restrictive of tax jurisdiction.[351] The relevant question here is, is it reasonable to use option A when option B imposes lesser restriction on the tax jurisdiction of a country? If there are alternative methods to allocating taxing rights or to achieve the objective of double taxation relief, the choice of a method that imposes relatively stringent restrictions on the taxing rights of LIDCs may be deemed unreasonable, unless there are compelling justifications for adopting the more restrictive method. This test calls for a comparative assessment of principles and measures relating to or affecting the allocation of tax jurisdiction. Selecting between two or more competing approaches – separate entity vs unitary taxation, for instance – can prove to be both complicated and controversial, as countries would generally prefer the option that best aligns with their fiscal interests; and, arguably, the choice of one option over another may be more political than technical. Moreover, even on the technical side, the choice is not always clear-cut.

We can also approach this factor from the perspective of qualified restriction. The view here is that while contemplating the adoption of a certain international tax compromise, policymakers should also consider any qualifications which, if embedded, can mitigate the restrictive effect of the proposed measure on the tax jurisdiction of countries. This element provides a basis for policymakers to, for instance, incorporate factors like location savings in transfer pricing regimes. Such qualification can help to bring more equity to an international tax compromise that would otherwise underrepresent or undervalue the contributions of certain jurisdictions to the value chain where such contributions become the basis for allocating taxing rights.[352]

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[351] Generally, the international tax regime has grappled with a problem of alternative choices for as long as its existence. The 1923 Report of the League of Nations discussed alternatives to double taxation relief. In 1928, the Technical Experts appointed by the League of Nations' Financial Committee produced three alternative model tax treaties to give countries a range of options on tax compromise. During the same period, and until now, countries have grappled with the issue of taxing rights apportionment between source jurisdictions: largely a choice of arm's length apportionment or formulary apportionment.

[352] Vet, Cassimon & de Vijver *supra* note 19.

Perhaps, we can digest the alternativity factor by revisiting Article 8 of the OECD MTC. That clause grants the country of residence of an enterprise operating ships or aircrafts (collectively "mobile vessels") in international traffic the exclusive right to the tax profits derived from such operations.

The international shipping and air transport industry (collectively) is worth trillions of U.S. dollars yearly and is still growing in value.[353] It is implicit that source countries – the countries from where shipping and air transport operators receive payments in exchange for their services of loading, conveying, and offloading people and cargo – can raise substantial revenue from taxing these activities. The equity question, therefore, is whether only countries of residence should enjoy the right to tax? To answer this question, I must first trace back the historical justification for the current position.

The principle of exclusive residence-based taxation of income derived from the operation of vessels in international waters – and air – evolved as a practice between the mid-19th to early 20th centuries.[354] In the early 20th century, countries such as the United States and the United Kingdom made attempts to impose source taxes on international shipping, but could not find an administratively feasible way to do it. From 1916, the United States attempted in futility to implement several formulas to apportion the shipping profits earned in its territory by foreign owned vessels.[355] Both the United States and the United Kingdom also faced severe criticism from other states, as well as the shipping industry, for the problematic tax measures that they sought to

[353] Martin Placek, "Container Shipping – Statistics & Facts" (23 September 2021) online: https://perma.cc/5X22-5XXG ["global maritime container trade is estimated to account for around 60 percent of all seaborne trade, which was valued at around 14 trillion U.S. dollars in 2019"]; ICAO, "Future of Aviation", online: https://www.icao.int/Meetings/FutureOfAviation/Pages/default.aspx ["aviation represents 3.5 per cent of the gross domestic product (GDP) worldwide (2.7 trillion US dollars) and has created 65 million jobs globally".].
[354] Guglielmo Maisto, "The History of Article 8 of the OECD Model Treaty on Taxation of Shipping and Air Transport" (2003) 31:6/7 Intertax 232.
[355] *Ibid* at 234.

implement, and it appears that both countries were moved by the concern that taxing foreign shipowners would invariably lead other countries to tax British and American shipowners.[356] In the end, after conferring extensively with other states, both countries ultimately legislated to forgo source taxation. The United States and several European states, therefore, started to either unilaterally or through bilateral tax treaties give up their right to tax international shipping income at source.[357] Countries that acted unilaterally usually extended the benefit on a reciprocal basis. That is, countries made the benefit of source non-taxation available to only vessels resident in (or owned by entities resident in) countries who extended a similar treatment to their vessels.[358]

For all countries, administrative infeasibility was the defining reason for the exemption of income from international shipping from source taxation.[359] According to Maisto:

> Exempting income from operation of vessels and aircraft was viewed by States as a practical solution to double taxation of income as any apportionment formula proved to be unsatisfactory; the exemption was construed as an *exception to the territoriality rules* on direct taxation (as opposed to the alternative represented by the *extraterritoriality* of the income which could have been applied to non-residents under certain circumstance).[360]

From the work of the League of Nations to the OECD, there are several confirmations of the administrability justification for exempting international shipping income from source taxation. A report published in 1925 by the Technical Experts appointed by the League of Nations' Fiscal Committee notes that:

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[356] Jacques Sasseville, "Historical Background of Proposed Changes to Articles 8 and 15(3) OECD Model" in G Maisto, ed, *Taxation of Shipping in Domestic Law, EU Law and Tax Treaties* (Amsterdam: IBFD: 2017) 73 at 74.
[357] For instance, United States: Revenue Act, 1921, section 213(8) [(8) ["The income of a nonresident alien or foreign corporation which consists exclusively of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States."]. See also United Kingdom: Finance Act, 1923, section 18 [establishing a treaty-based tax exemption of foreign shipowners' income].
[358] For an extensive discussion of these measures and how countries went about implementing them, see Sasseville *supra* note 356.
[359] Maisto *supra* note 354 at 234–235.
[360] *Ibid.*

> In the case of maritime navigation undertakings, in view of the very particular nature of their activities and of the difficulty of apportioning their profits, particularly in the case of companies operating in a number of countries, the experts admit an exception to this principle – to the effect that the tax should, subject to reciprocity, be imposed only by the country in which the real centre of management and control of the undertaking is situated.[361]

The reasoning behind the above submission is explained by the Technical Experts as follows:

> When an industrial concern carries on its activities throughout the whole world, the importance of the actual headquarters, or the "brain" of the enterprise, becomes paramount; and, above all, very serious technical difficulties may be encountered in determining an apportionment of the profits. The representatives of the Maritime Sub-Committee of the League of Nations have asked how it is possible to determine the profits earned in each of the twenty or twenty-five ports at which a vessel belonging to a trans-Atlantic company may have loaded or discharged cargo, when ten or fifteen different countries have to be taken into consideration.[362]

The principle was originally applicable to maritime navigation, but was subsequently extended to air navigation, recognizing the advancement of the industry, through the 1928 Geneva Model Convention, also developed under the coordination of the League of Nations. The extension of the special rule of exemption to air navigation was done in acknowledgment of the fact that this form of transportation raises similar double taxation concerns.[363] The subsequent Mexico and London Models also contained the principle of exclusive residence country taxation with the explanation that granting exclusive taxation to one country was "intended to facilitate the operation of international transport enterprises" and "also avoids the numerous difficulties which experience

[361] Financial Committee, *Double Taxation and Tax Evasion – Report and Resolutions Submitted by The Technical Experts to the Financial Committee of the League of Nations League of Nations* (Geneva: League of Nations, 1925) at 31.
[362] *Ibid* at 16.
[363] Georg Kofler, "Article 8 OECD Model: Time for a Change?" in G Maisto, ed, *Taxation of Shipping in Domestic Law, EU Law and Tax Treaties* (Amsterdam: IBFD: 2017) 112 at 115.

has shown to be involved in the taxation of profits from international navigation outside the home-country of the operating enterprise".[364]

The principle was reaffirmed by the OECD during the development of the first OECD MTC of 1963. The Working Party assigned the task by the OECD considered that deviating from the general principle of business income taxation (including the permanent establishment rule) and maintaining a special regime for the taxation of income from international shipping and airport operations was necessary for administrative reasons:

> The rule of reciprocal exemption of foreign shipping or air transport enterprises, giving the taxing power to the State in which the enterprise has its place of management or its fiscal domicile, can perhaps be criticised on ground of principle (derogation from the principle of permanent establishment). <u>But, from the practical standpoint, in view of the condition of international navigation, this rule must, in the opinion of Working Party No. 5, be regarded as the most suitable and most rational method of avoiding double taxation.</u> Consequently, it is presumable that principle of reciprocal exemption will still be the basis of all future work in the field of bilateral Conventions.[365]

These considerations also reflects in the Commentary on the 1963 OECD MTC:

> By the nature of their business, shipping, inland waterways transport and air transport enterprises are more exposed than most other industrial and commercial enterprises to the danger of multiple taxation on their income, as they are liable to be taxed simultaneously in their own countries and in the other countries where they receive payment for the carriage of passengers or goods or where their activities are exercised. To avoid double taxation, many special Conventions concerning the taxation of these enterprises have been signed or special clauses inserted into general double taxation Conventions. <u>As it would be very difficult to determine what proportion of the profits of a shipping or air transport enterprise is attributable to each of the countries concerned, most Conventions provide that income from the international business of shipping or air transport is to be taxed only in the State in which the enterprise concerned is established</u>.[366]

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[364] Financial Committee, *Commentary on Article 5, London and Mexico Model Tax Conventions – Commentary and Text* (Geneva: League of Nations, 1946).
[365] OEEC, Working Party No.5 of the Fiscal Committee, *Report on the Taxation of Income and Capital of Shipping and Air Transport Enterprises and of their Crews,* FC/WP5(57)2 (Sweden, Belgium, OEEC: 1957), Annex III at 13.
[366] OEEC, *2nd Report of the Fiscal Committee of the OEEC on the Elimination of Double Taxation* (1959), paras 20 & 21.

From the foregoing historical reflections, it is clear that the Article 8 exclusion of source country taxation is mainly justified on account of administrative feasibility of applying taxes at source without imposing multiple tax burdens on shipping and air transport operators.[367] The administrative hurdle underlying this principle has to do with peculiarities in how international shipping and air transport enterprises typically operate. According to Kofler:

> [T]his exclusive taxation takes account of the way in which international shipping and air transport industries are typically organized, as their operations may be spread out over a multitude of states in which PEs are set up to handle the business: Exempting such profits from tax in the state where the activities were exercised, regardless of whether or not the enterprise maintains a PE in that state, article 8 of the OECD Model indeed avoids difficulties in allocating to each PE (e.g. docks, hangars, cargo terminals, ticket offices, etc.) its proper share of the profits arising from transportation activities and fragmented taxation of profits.[368]

Kofler contends that there is broad agreement to retain the special rules regarding Article 8 even in times where the source taxation is being strengthened and the threshold for permanent establishment is being lowered. This is because, according to the author:

> Even in times where source taxation is strengthened and the threshold for the existence of a PE is lowered for other businesses, there seems to be broad agreement on the necessity of such a rule for the shipping and airline industries and the corresponding justification for the deviation from the general rule of article 7 of the OECD Model. This is because reciprocal exemption avoids multiple taxation and considerable difficulties of income allocation in a very large number of taxing jurisdictions. This is specifically true for modern-day liner shipping, where a carrier's service involves multiple ports of call and multiple international cargo origins and destinations on every single voyage, but could also be the case in tramp shipping, i.e. the maritime transportation of bulk materials, which may exhibit similarities to containerized trades.[369]

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[367] It should be noted that in terms of scope, Article 8 only covers profits arising from the operation of vessels. It does not cover ancillary activities such as the profits of traveling, customs and emigration agencies, all of which remain subject to the general business profits rules. See Maisto *supra* note 354 at 241; Florian Haase, "Double Tax Treaties: Practical Problems in Article 8 of the OECD Model Convention" in O Schinas, *et al,* eds, *HSBA Handbook on Ship Finance* (Berlin: Springer-Verlag, 2015) at 234.

[368] Kofler *supra* note 363 at 116.

[369] *Ibid* at 119.

It is not disputed that, like other forms of international economic activity, international shipping and air transport gives rise to competing taxing rights between two or more jurisdictions: the country of residence, the country of source and, in this case, multiple countries of source. It seems that the entire justification for the outright exemption from source taxation of international shipping and air transport income – perhaps one of the swiftest compromises ever built on a multilateral engagement – rests on the notion that there is simply no way to allocate this type of income to the potentially many source countries without causing unsustainable double (multiple) taxation for the industry. The only prudent choice, therefore, is for all source countries to surrender their taxing right in favor of exclusive residence country taxation.

The Article 8 rule is a quintessential example of efficiency – and, in this case, administrability – overriding equity in international tax regime formation. Indeed, the complex intersection between these three policy objectives of international taxation is evident throughout the evolution of Article 8. On the one hand, the elimination of double taxation of income from international shipping and air transport, generally, became a genuine necessity, as states recognized double taxation as a significant barrier to efficient markets.[370] Efficiency also factors in determining the protracted question of whether taxing rights (at residence) should be reserved for the state of registration of the vessel – the so-called "flag of convenience problem"[371] – or the central location where the operations are managed from (the "real centre of management and control" or, subsequently, "place of effective management").[372] Second, the preferred method of dealing with the double

[370] Sasseville *supra* note 356.

[371] See Sang Man Kim & Jingho Kim, "Flags of Convenience in the Context of the OECD BEPS Package" (2018) 49:2 J Maritime L & Commerce 221.

[372] The subject is extensively discussed by Maisto *supra* note 354; Kofler *supra* note 363 and Sasseville *supra* note 356. In sum, this has been the most protracted issue in the development of Article 8, one that has received repeated consideration from various international bodies, including the League of Nations and the OECD. While there has been a longstanding consensus to exclude source taxation, it has proven more difficult to agree conclusively on the designation of the "state of residence" that should be apportioned the right to tax; and states practice on the subject

taxation problem (exclusive residence taxation) draws largely from administrative feasibility.[373] Yet, equity was also a major consideration in the development of Article 8. This is first reflected in the concern of states for reciprocal treatment in the surrender of source taxing rights. A state was willing to give up source taxation if its own residents could receive the same treatment from other states as they navigated international waters and air.[374] Also, despite the imperative of eliminating double taxation, some states were not willing to accept wholesale elimination of source taxing rights. Their concern was peculiar about the taxation of income from inland waters navigation. This led to a carveout for source taxation of vessels operating in the territorial waters of a state (inland navigation) from the general rule of source non-taxation, which now applies only to vessels operating in the high seas (maritime navigation).[375]

The reasonableness of the contrasting treatments of inland navigation and maritime navigation stems from the fact that, unlike inland navigation, most of maritime navigation takes place outside the territorial waters of a source state.[376] So, from a comparative equity perspective, it might seem

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varies. The discussion is primarily centred on the distinction between the "real centre of management and control" (more recently tagged the "place of effective management" (POEM)) where the activities of the vessel owner are located or the place of registration of the vessel or incorporation of its owner (the so-called "flag state"). Tax treaty models and draft models have mostly reflected the former test, as a way of ensuring efficiency, except for the Mexico Model of 1943 which preferred the state of "registration" approach. The OECD MTC recognized only the POEM approach until the 2017 iteration, which allowed individual states to choose their preferred definition of "residence". See Article 4(1) OECD MTC. Many tax treaties use the POEM phrase. Although its meaning varies from state to state, Falcão notes that "in general the place of effective management is the place where the key management and commercial decisions are made in substance, where the most senior person or group of people (for example, a board of directors) makes its decisions, or where the actions to be taken by the enterprise as a whole are determined". Tatiana Falcão, "Can the Digital Economy Debate Improve the Taxation of International Shipping Profits?" (2020) 99:8 Tax Notes Int'l 1065 at 1068–1069.

[373] When exercising their right to tax at residence, most states either grant an exemption or use the tonnage system which assesses tax liabilities based on the weight of the cargo, rather than on the net profits of the enterprise. This practice has been described as generous and it is deliberately designed to retain the residence maritime enterprises who may relocate to other countries if they were more stringently taxed. On the whole, "the widespread application of this scheme is the undertaxation of a very concentrated and profitable enterprise". Falcão *supra* note 372 at 1070.

[374] Sasseville *supra* note 356.

[375] *Ibid.*

[376] It should be noted that the OECD MTC from 1963 until 2017 specified that income from the operation of boats engaged in territorial inland waterways transport shall be taxable only in the state where the effective management and control of the enterprise is situated. This prescription effectively extended the rule of exclusive residence taxation to inland waters navigation, contrary to what was obtainable in preceding tax treaty models. This prescription was

less reasonable to expect a source country to agree to not tax inland navigation which takes place almost entirely within its territorial waters, under near exclusive protection of its laws, regardless of the place of residence (or registration) of the vessel.[377] The fundamental problem of profit apportionment that bedevils the administration of a tax on international navigation is implicitly less pronounced in inland or territorial waters navigation since the entire income more likely derives from a single source country and is, therefore, more readily attributable to that source.

Logically, the question that follows is whether a rule that excludes source country taxation of income from international shipping and air transport should still be considered "reasonable" if there is an "alternative" (administratively feasible) way to deal with the double taxation problem without the extremity of taxing rights exclusion for source countries? In other words, it is worth questioning whether the total exclusion of source taxation of income from maritime and air transport continues to be a reasonable impairment of source tax jurisdiction or whether there is an alternative solution that is reasonable in terms of how it addresses the trilemma of double taxation, administrative feasibility, and inter-nation equity. This issue – which seemed settled for decades – appears to be worth revisiting partly because of the strain that the current exclusionary rules place on domestic revenue mobilization in LIDCs and partly because of how the rules have allowed the

altogether eliminated in 2017 largely out of redundancy. Most countries did not address taxation of nonresidents operating in inland waterways in their tax treaties.

[377] In the early years of the development of the Article 8 rule, some source states strenuously objected to the inclusion of territorial waters navigation in the exclusive residence state taxation rule. Countries like Argentina were of the view that most of the services in territorial navigation took place within their territory, under their protection and accounted for a substantial part of their domestic revenue. There was, therefore, no basis to exclude their right to tax income arising from these activities. This objection appears to have been a major factor in the carveout; and remained the consensus position until 1963 when the pioneer OECD MTC purported to place all forms of navigation (air, maritime, and inland) within the exclusive residence taxation rules. See Maisto *supra* note 354 at 238 & 244.

shipping industry to become a "low- or no-tax industry" benefitting from the harmful competition between states to become "registration states".[378]

The UNMTC prescribes an alternative framework for the Article 8 rule that is more accommodating of source taxation than what is currently contained in the OECD MTC. Article 8 (alternative B) of the UNMTC provides that:

> 2. Profits of an enterprise of a Contracting State from the operation of ships in international traffic shall be taxable only in that State unless the shipping activities arising from such operation in the other Contracting State are more than casual. If such activities are more than casual, such profits may be taxed in that other State. The profits to be taxed in that other State shall be determined on the basis of an appropriate allocation of the overall net profits derived by the enterprise from its shipping operations. The tax computed in accordance with such allocation shall then be reduced by ___ per cent. (The percentage is to be established through bilateral negotiations.).[379]

It has been observed that "exclusive residence state taxation of shipping profits is problematic when the size of mercantile fleets and shipping flows between two states are unequal in size".[380] Such an outcome is more likely to play out in relations between a developed and developing country because the LIDC would often lack the domestic mercantile fleet but would nevertheless

[378] Falcão *supra* note 372 ["Taxation of International Shipping Profits"]. In essence, there are both efficiency and equity reasons to deal with the issue. In terms of efficiency, because, Article 4(1) OECD MTC recognizes discretion of a state to define resident as "domicile, residence, place of management or *any other criterion of a similar* nature", in their domestic legislation or tax treaties, shipowners are heavily incentivized to incorporate their business only in the states with the most accommodating definition of residence and where they can receive the most generous tax benefits rather than in their actual home states or the states where they have significant activities. This situation, in turn, pushes states to indulge in harmful tax competition to attract shipowners to register their business there. This regressive competition ultimately drives down the effective rate of taxes that shipping activities incur globally. Effectively, neither the countries of source, nor the countries of actual residence where shipping entities operate from can tax a highly valuable global sector which benefits massively from the rules and protection that are offered by the international community. Even though the original intent of the Article 8 special rule was to eliminate double taxation, it is hard to imagine that it was intended for the rule to become an instrument of double non-taxation, so to speak.
[379] "Article 8A" is a reproduction of the OECD MTC prescription.
[380] Bob Michel & Tatiana Falcão, "Taxing Profits from International Maritime Shipping in Africa: Past, Present and Future of UN Model Article 8 (Alternative B)" (2021) ICTD Working Paper 133 at 3.

serve as a viable revenue generating port state for the developed country's fleet.[381] In such circumstances, the UNMTC's provision can be considered a more equitable alternative for source countries, especially LIDCs who may not have commensurate ownership stakes in international transportation entities or vessels, vis-à-vis HIDCs (except, perhaps, as "flag states"), but who, nevertheless, desire to tax significant income outflows from their territories to non-resident enterprises operating in the air and sea transport industry.[382]

Article 8B also seemingly attempts to mitigate the potential double taxation problem – the kind identified by Samuel Instone in 1928[383] – by allowing source states to tax only where the shipping activities are "more than casual", i.e., where the shipping activities are (deemed) significant. The question of what amounts to "more than casual" shipping activities is a threshold question which states can address by compromise. The UNMTC does provide guidance on what the phrase entails. Paragraph 13 of the Commentary to Article 8 of the UNMTC stipulates that the "the phrase 'more than casual' means a scheduled or planned visit of a ship to a particular country to pick up freight or passengers". Of course, such threshold prescriptions are not new to international taxation. A prominent quantitative example can be readily found in the rules governing business profits taxation, particularly the permanent establishment thresholds stipulated in Article 5. Therefore, states can explore the potential of a more appealing threshold.

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[381] *Ibid.* See also Amar Mehta, "Taxation of Shipping Income under Tax Treaties – Development of Case Law in India" (2015) 21:3 Asia-Pacific Tax Bulletin [observing that about 90% of India's maritime cargo is handled by foreign carriers].

[382] For a criticism of the Article 8B UNMTC provision, see Muhammad Ashfaq Ahmed, "UN MTC Article 8: Was the Source Rule Surrender on Article 8 a blunder? The Case Study of Pakistan (2020) 48:1 Intertax 103 [arguing that the UNMTC review does not go far enough because it does not adequately assert the principle of source taxation of international traffic. The author calls out the irony in the fact that a great majority of tax treaties signed by LIDCs purportedly modelled on the UNMTC abdicate source taxation of international traffic].

[383] Sir Samuel Instone, Director of the International Air Transport Association and representative of the ICC in Minutes of the session of the General Meeting of Government Experts held in Geneva on 22-28 October 1928, quoted in JG Herndon 207 ["the aeroplane service from Holland to the East Indies had to cross several countries and come down for reasons in different territories. If that service had to pay taxes in every country it crossed, there would be nothing left and the company might as well sell its planes"].

The nexus between the "more than casual" requirement and administrability is vital. After all, if the potential for administrative feasibility has not evolved to a satisfactory level, any attempts to tax income from international shipping would still prove problematic for taxpayers and tax authorities. If non-taxation at source, or overall, is inequitable, multiple taxation might be even more detrimental (to the shipping industry), and perhaps, even reignite drumbeats of trade war. Therefore, it is helpful that the UNMTC contemplates that, where contracting states adopt Alternative B, the authorities in the state of residence of the enterprise should assess the overall net profits of the entity. The contracting states must then agree on the formula for apportioning the net profits between the residence and source state(s).[384]

If states adopt the option (Alternative B) that the UNMTC presents, they have to rely on the availability of information to apportion the enterprise's profits for assessment. Thankfully, as Falcão observes, and contends, taxing the shipping industry does not face as much complexity as taxing the digital economy because, unlike the digital economy, "shipping traffic, port calls, and merchandise transactions are extensively monitored – and unlike the digital economy, it is not just the shipping companies themselves that conduct the monitoring but also third parties".[385] Shipping documents, which are normally filed at port, can reveal how many trips a vessel makes to the ports of a given jurisdiction, the size and/or value of cargo loaded and offloaded there and ultimately the turnover income that the vessel or enterprise derives from its operations in that jurisdiction. Where tax authorities are cooperating, in terms of information exchange, the consolidated data that is available to them may be used as the basis of a, potential, formulary apportionment of profits between source jurisdictions or between residence and source jurisdictions, in which case, only

[384] UNMTC, Commentary on Article 8, para 14.
[385] Falcão, "Taxation of International Shipping Profits" *supra* note 372 at 1070.

"residual profits" from maritime shipping would be allocated to the source state (or market economy).[386]

Contracting states can agree that unless the income that a foreign shipping enterprise derives from a source state is "more than casual", i.e., based on a threshold defined by their compromise, then there would be no obligation for the entity to pay taxes in that source state. Indeed, for administrative purposes, stipulations may also be made to exclude filing obligations in a state where the shipping activities do not reach a certain threshold. So called "safe harbor" provisions are already a part of the international tax regime, particularly in the regulation of transfer pricing filings.[387]

It is difficult to see why similar strategies cannot be adapted to the taxation of income from international shipping. Unlike in the last century, the existence of things like country-by-country reporting, as well as digitalized country-specific data, means that countries now have better tools to access and assess the taxability of shipping enterprises; and, as stated earlier, apportionment of profits can be made on the basis of an agreeable formula that operates on readily available data. Therefore, the administrative strings that rendered tax assessment and compliance a non-starter for the shipping industry have been lowered significantly by technological advancements and more sophisticated regimes of transnational cooperation in tax administration. Again, compliance burdens for taxpayers can be eased by technology and by limiting source taxation to predetermined

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386 See Falcão *ibid.*

387 See OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (Paris: OECD, 2017) at 205 ["A safe harbor "applies to a defined category of taxpayers or transactions and relieves eligible taxpayers from certain obligations otherwise imposed by a country's general transfer pricing rules"]. For concept analysis, see, e.g., Thomas W. Giegerich, "Transfer Pricing Safe Harbors - An Idea Whose Time Has Come" (2017) 43:5 Int'l Tax J 35; Gregory Pun, "Base Erosion and Profit Shifting: How Corporations Use Transfer Pricing to Avoid Taxation" (2017) 40:2 B C Int'l & Comp L Rev 287; Alexander Ezenagu, "Safe Harbour Regimes in Transfer Pricing: An African Perspective" (2019) ICTD Working Paper 100; Tatiana Falcão "Formula-Based Transfer Pricing: How Brazil Can Improve the OECD's Framework" (2021) 101:5 Tax Notes Int'l 609.

thresholds of significant economic participation in a source state. The inclusion of a safe harbour threshold also limits the number of states where taxpayers are required to file. If a shipping entity's operations in a state do not produce a turnover that meets a certain threshold, then it may be exempted from even filing returns in that state. This way excessive compliance burdens do not fall on shipping entities in states where they have a *de minimis* economic involvement.

The absence of international consensus on the revamp of Article 8 does not mean that source countries are asleep on the subject. Indeed, it appears that a growing number of countries is moving away from the anachronistic practice of source non-taxation that remains embedded in Article 8 OECD MTC. A recent study by Michel & Falcao reveals that a host of South/South-East Asian states now have language in their treaties that is similar to Article 8B and in some cases, countries are leaving the subject out of their tax treaties and taxing shipping income at source pursuant to their domestic tax rules.[388] These countries also stipulate certain practical requirements that are meant to mitigate the likelihood of double taxation. For instance, all Bangladeshi tax treaties that do not exclude source taxation provide that the tax charged in the source state shall be reduced by 50%. In some of the treaties, it is further prescribed that after all reduction of the 50% the eventual tax shall not exceed 4% (2.5% in one treaty) of gross receipts.[389] The fact that these "deviant" provisions have existed for decades reinforces the contention that there are viable – and more equitable – alternatives to the OECD MTC prescription.

In sum, if the total exclusion of source taxation in Article 8 is (or was) justifiable on the basis of double taxation and the lack of a workable profit appropriation method for source taxation, the existence of an alternative framework that deals with these practical concerns but also allows

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[388] Michel & Falcão *supra* note 380.

[389] *Ibid* at 29. Presumably, the low-rate turnover tax is meant to ensure as much proximity as possible with an actual net rate taxation, in the same way that withholding taxes on passive income function.

source countries to tax renders questionable the continued reasonableness (equitableness) of the OECD MTC approach and the rationale for its perpetuation. The alternative framework, the UNMTC (Alternative 8B), still impairs source tax jurisdiction but, compared to the subsisting OECD MTC approach, its impairment may be considered (more) reasonable.

2.3.3.5 Scope for Non-Tax Benefits

This evaluative criterion compels me to revisit the reasons why countries agree to compromise their tax jurisdiction in the first place; and here I am looking beyond the overarching reason: elimination of double taxation. I am looking more specifically at those individualistic reasons for compromise, such as the attraction of foreign capital and the import of foreign technology. A complete evaluation of reasonableness would take into account the scope for non-tax benefits that a country derives from compromising its tax jurisdiction. In other words, when we evaluate the reasonableness of a tax compromise, including one involving an LIDC, we should include in that evaluation the scope for tangible non-tax benefits that the country stands to benefit from the regime.[390]

Giving up the right to tax may be viewed as a tradeoff for other benefits arising from international economic integration. Attraction of foreign capital has been a primary motive for LIDCs' willingness to give up tax revenue through tax treaties.[391] In a world of unequal capital ownership capacity, it is not uncommon for LIDCs to enter into tax treaties with HIDCs as a strategy to attract foreign capital.[392] There are conflicting views on whether giving up taxing rights in exchange for

[390] Non-tax benefits may take the form of human development, infrastructural investment and transfers of technology between countries or the provision of services which were hitherto not readily available.
[391] Hearson *supra* note 15.
[392] *Ibid.*

foreign capital tends to yield the desired results especially for LIDCs or whether the potential results of compromise are an acceptable trade-off for lost tax revenue.[393]

Tax treaty practice experience suggests that split withholding tax rates on taxation of royalties can be used as policy tool to streamline the import of intangibles. There is no universally prescribed or acceptable royalty tax rate for tax treaties. Instead, the rates prescribed in tax treaties – where taxation at source is permissible – are usually the outcome of bilateral treaty negotiations.[394] Some countries insert a singular royalty rate for the various forms of IP included in the definition of royalties, while others use split rates, which means different rates for different classes of intangibles. Is this the best approach, or would split royalty rates be more beneficial for LIDCs? Whether a singular rate or a split rate is preferable may depend on the LIDC's priorities. If the priority is to attract the import of certain kinds of IP, then a split rate may be the reasonable policy.

Some of the tax treaties between LIDCs and HIDCs reflect tax rates variations from treaty to treaty and, sometimes even in the same treaty there may be different rates for different forms of royalty income.[395] For instance, each of Chile's tax treaties with Australia, Belgium, and France, contains

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[393] For instance, see Yitzhak (Isaac) Hadari, "Tax Treaties and Their Role in the Financial Planning of the Multinational Enterprise" (1972) 20:1 Am J Comp L 111 at 125 ["Very commonly today developing countries offer tax concessions to encourage investments. Yet, as representatives from these countries have been at pains to point out, such concessions are often frustrated in their purpose of attracting foreign capital, and only serve to increase the tax revenue of the investor's home country"]; Dagan, "The Tax Treaties Myth" *supra* note 283; Eric Neumayer, "Do Double Taxation Treaties Increase Foreign Direct Investment to Developing Countries?" (2007) 43:8 The J Dev Stud 1501 ["This is the first study to provide evidence that developing countries that have signed a DTT with the US or a higher number of DTTs with important capital exporters actually do receive more FDI from the US and in total. However, DTTs are only effective in the group of middle-, not low-income developing countries"]. Although studies like Neumayer's demonstrate that some developing countries can receive increased FDI from signing tax treaties with HIDCs, it remains uncertain whether the increased FDI makes up for the substantial tax revenue losses. See Janský & Šedivý *supra* note 242.

[394] The UNMTC which allows source countries to tax royalties does not include or recommend a withholding tax rate for royalties. However, it can be inferred from the drafting of Article 12 of the model that it contemplates a single withholding tax rate for royalty, regardless of the type of IP for which royalty is paid. What is considered by some to be a high royalty rate may be considered low by others. In any case, one of the concerns about imposing a high royalty tax rate is that the burden of paying the tax may be passed to the licensee, which essentially increases the cost of doing business for the licensee and, potentially, makes it less competitive with enterprises resident in lower tax countries.

[395] Article 12 of the Argentina-UK tax treaty contains a 15% general royalty tax rate, but also carveout rates of 3% (news) 5% (copyright of literary, dramatic, musical, or other artistic work…); and 10% (patent, trademark, design or

a withholding tax rate of 10% for royalties, but then carves out a 5% rate for royalties paid for industrial, commercial, and scientific equipment.[396]

One plausible rationale for this kind of rate disparity is that the LIDC prioritizes the import of certain intangibles (e.g., patent and know-how); hence, the willingness to concede to a lower withholding tax rate on royalties paid for that form of property aims at incentivizing imports of those forms of intangibles. In this sense, what we have is a trade-off between technology imports and tax revenue. The royalty rates may even be zero if the 'source' country deems it necessary. The items that benefit from this low – or zero – rate may be further streamlined to meet the specific non-tax needs of the technology importing country (LIDC), while, as much as possible, limiting the erosive impact of the treaty on domestic revenue mobilization.[397]

Regardless of where one stands on the trade-off debate, I am of the view that it is a necessary component of a holistic reasonableness analysis. If a country stands to derive genuine, tangible, and proportionate non-tax benefits from compromising its taxing rights, then the tax revenue given up may not be considered unreasonable, even for an LIDC.[398] After all, as Diane Ring implores, "*a country must measure its success by more than its current tax revenue; economic growth is also valued. If tax rules discourage taxpayers from engaging in otherwise desirable cross-border transactions, there may be a significant drag on the resident economy and*

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model, plan, secret formula, or process; industrial or scientific equipment; information concerning industrial or scientific experience; the rendering of technical assistance).

[396] Australia-Chile 2010 Income and Fringe Benefits Tax Convention and Final Protocol; Double Tax Treaty, Article 12; Belgium-Chile 2007 Income and Capital Tax Convention and Final Protocol, Article 12; Chile-France 2004 Income and Capital Tax Convention and Final Protocol, Article 12.

[397] There are both potential merits and demerits to adopting either a singular or split tax rate for royalties. One concern with a split rates policy is that it may result in characterization problems. This may lead to inefficiencies and administrative difficulties where taxpayers and tax authorities disagree on where particular payments fall. This potential concern suggests that it might be better policy, generally, to use the singular royalty rate format. Egypt's tax treaties all contain singular tax rates for royalties (ranging from 10%-25%), except for the treaties with Belgium and Germany, which contain split rates for trademarks.

[398] This is why empirical data is crucial for negotiations of tax compromise.

revenue".[399] However, the scope for non-tax benefits should, generally, not be a standalone consideration, at least not for long-term compromises, unless it is clear that the derivable non-tax benefits substantially outweigh the need for domestic revenue mobilization.

2.4 Chapter Conclusion

In chapter one, I discussed what I consider to be a narrative problem in the way inter-nation equity issue is presented for LIDCs. In this chapter I have attempted to demonstrate a different approach to framing the issue. I began by discussing what it means for a sovereign state to have tax jurisdiction, using different theories that scholars have propounded over the years. I concluded on the note that scholars have settled on the theory of "economic allegiance" as the basis for tax jurisdiction, and that "economic allegiance" best reflects as residence and source tax jurisdiction. In that light, I also tried to demonstrate (and have reiterated throughout these chapters) that the jurisdiction to tax, as a matter of principle, is not conferred or donated by one country to another. I proceeded to examine what the international tax regime does to the tax jurisdiction of states. I argued that the regime principally impairs or restricts the exercise of tax jurisdiction. In other words, the regime does not strip tax jurisdiction, but restricts a state's capacity to exercise jurisdiction. I argued that this impairment is most pronounced in the respect of source taxation. The principal purpose of impairment of tax jurisdiction is the elimination of double taxation. This explains the nomenclature of "double taxation regime" by some scholars.

I then proceeded to discuss what a reasonable compromise should look like, considering that I present the RIC concept as the way to frame the inter-nation equity question. In this regard, I discuss the concept of "reasonableness" as used in some of the literature. I then conclude by discussing various approaches to reasonableness that may be used to evaluate the fairness of an

[399] Ring *supra* note 2 at 124.

international tax compromise. I use various case studies, drawn mostly from subsisting tax treaty provisions, to articulate the points in each test.

There is an international tax "deal of the century" on the horizon. This new tax deal aims to apportion taxing rights with respect to the digital economy. There are conflicting views on whether the deal is fair to LIDCs. I have tried to steer clear of that subject thus far. What I proceed to do in chapter 3 is to use the framework that I have built in chapter 2 to evaluate the equity concerns around the new tax deal.

Chapter 3 also discusses the political dynamics that surround the formation of international tax compromises, that is the process through which sovereign states agree to impair or restrict their exercise of taxing rights. I leverage various theoretical and historical perspectives to demonstrate that this process is technical, but also highly political. States with greater economic power are more likely to influence the outcomes. However, the level of pressure and scrutiny that non-state actors, including economic interest groups and tax policy scholars, exert on the political process also influences the compromises that states make.

Chapter 3: Taxation of Active Business Income in the Digital Era

3.1 Overview

As the preceding chapter documents, the normative principles of the international tax regime were framed about a century ago, mainly from the League of Nations' 1923 Report to the entrenchment of the permanent establishment principle in the 1963 OECD MTC. It is important to mention the permanent establishment principle because it is the specified nexus threshold based on which a source state may exercise jurisdiction to tax the business profits of a non-resident entity.[400] "Permanent establishment" entails a physical presence in the source country of the form contemplated in Article 5 of the OECD MTC, as well as the UNMTC, the tax treaties and domestic laws of states, and may be regarded as one of those international tax principles that have attained the status of customary international law.[401] The permanent establishment threshold requires, as a precondition for the exercise of source country tax jurisdiction, that the non-resident entity maintains a certain physical presence in the source country and derives income from activities attributable to that identifiable presence or location. The presence may include an office, a place of management, a branch, a factory, a workshop, or place of extraction of natural resources.[402]

The permanent establishment principle evolved as a compromise between mainly capital-exporting countries seeking to tax business profits predominantly or entirely at residence and mainly capital-importing countries seeking to tax business profits predominantly or entirely at source and heralded an initial breakthrough in the partition of international taxing rights.[403] In the early-to-mid-20th century, when the permanent establishment principle evolved, cross-border

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400 Louise F. Kjaersgaard & Peter K. Schmidt, "Allocation of the Right to Tax Income from Digital Intermediary Platforms - Challenges and Possibilities for Taxation in the Jurisdiction of the User" [2018] 2018:1 NJCL 146 at 161.
401 See Avi-Yonah *supra* note 2.
402 OECD MTC, Article 5; UNMTC, Article 5.
403 See Wang *supra* note 145.

business activities of economic significance normally involved a physical presence in the source country – the so-called "brick and mortar" economy.[404] In those circumstances, it was reasonable to make physical presence a component of the source rules for taxation of business profits. That situation has changed quite significantly in the last few decades with the rapid digital transformation of the global economy.[405] A great deal of economic activities now take place remotely and an entity that is resident in one country can leverage digital technology to derive huge profits from another country without any physical presence there.[406] The digital transformation of the global economy has rendered the permanent establishment framework obsolete and unfit for purpose and, in the view of many, necessitates reform or deviation from the permanent establishment rule.[407] It is for this purpose that countries have been engaging multilaterally on a scale not seen since the early to mid-20th century to rewrite or adapt the rules of international taxation to address the tax challenges arising from the digital economy.

The reform of international tax rules requires a new compromise that would enable states to reclaim tax sovereignty by reversing some of the restrictions to the exercise of source tax jurisdiction. But it may also require some measure of continued concession of taxing rights for purposes of double tax avoidance, innovation enticement, administrative convenience, and even political feasibility. The question is how much taxing rights *should* states concede?

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[404] Asaf Harpaz, "Taxation of the Digital Economy: Adapting a Twentieth-Century Tax System to a Twenty-First-Century Economy" (2021) 46:1 Yale J Int'l L 57 at 62.
[405] For a definition of the commonly used terms "digital transformation" and "digitalization", see Jason Bloomberg, "Digitization, Digitalization, And Digital Transformation: Confuse Them At Your Peril", *Forbes* (29 August 2018) online: https://perma.cc/276K-6QZ9.
[406] Monica Gianni, "OECD BEPS (In)Action 1: Factor Presence as a Solution to Tax Issues of the Digital Economy" (2018) 72:1 The Tax Lawyer 255 at 259.
[407] Michael J Graetz, "Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies" (2001) 26:4 Brook J Int'l L 1357; Wolfgang Schon, "Ten Questions about Why and How to Tax the Digitalized Economy" (2018) 72 Bulletin for Int'l Taxation 278. Hentschel *supra* note 8.

A tentative global tax deal was published – and reviewed – in the middle of 2021. The deal is being presented as a framework for taxing rights allocation in the digital economy. The deal will, unsurprisingly, limit source taxation by setting determined thresholds for the exercise of those taxing rights. Nearly 140 countries, including many LIDCs, have signed up, amidst protests about its fairness, to LIDCs, especially.

This chapter evaluates the new global tax deal from an equity perspective, using the reasonable impairment compromise (RIC) framework developed in the preceding chapter. I start by examining the tax challenges of the so-called "digital economy". I proceed to introduce the multilateral efforts that countries are undertaking, through the OECD, to address these challenges. I then discuss the political circumstances underpinning the formation of the new global tax deal, showing how political dynamics shape the distributional outcomes of the deal. Finally, I conduct an inter-nation equity evaluation of the new global tax deal. Here, I examine the normative entitlement of source states to tax income arising from the digital economy; I establish the new global tax deal as a compromise that allocates taxing rights; I establish that the compromise impairs the exercise of tax jurisdiction by source states; and I analyze the question of whether the impairment of source tax jurisdiction can be deemed reasonable, based on three reasonableness tests: disparity of means, alternativity, and the potential for non-tax benefits. I conclude that there is no simple answer. There are components of the deal that can be faulted, based on their application to some countries. The new global tax deal falls short of the disparity of means test, even though there is an attempt at differentiated allocation of taxing rights to some LIDCs. The alternative that I review here better preserves the taxing rights of LIDCs but is beset by various difficulties of its own; therefore, I am not entirely convinced of its viability. Pillar One performs slightly better on the non-tax benefits test based on a general assessment.

3.2 The Tax Challenges of Global Economic Digitalization

Global trade has grown tremendously in the last few decades, from a nominal value of U.S.$22.7 trillion in 1990 to a nominal value of U.S.$87.6 trillion in 2020.[408] A lot of that growth is attributable to rapid advances and integration of digital technology into the global economy.[409] To this point, a recently published estimate by the United Nations Conference on Trade and Development (UNCTAD) puts the value of global e-commerce transactions, a key component of the digitalization trend, at a total of US$26.7 trillion.[410] This sort of impact is possible because digital technology enables easier and increased product diversity, thereby enhancing firms' capacity to produce, market and distribute their products at minimized costs.[411] Schmidt & Spengel describe the impact of digitalization in the following words:

> The digital transformation of industry (including "Industry 4.0") is progressing continuously. It revolutionises value creation processes and supply chains, makes production processes smart and promotes employees' know-how in dealing with innovative technologies. Not least of all, it influences business strategies and corporate culture. More and more digital business models are emerging, spurring on competition and disrupting entire sectors. At the same time, new digital opportunities work as a catalyst on research and development, for instance by stimulating innovation processes and shortening development cycles.[412]

Digitalization is transforming the way businesses interact with users and customers globally.[413] Digitalized businesses obtain and exploit user data for advertising, marketing, and other commercial purposes, platform operators break access barriers by connecting users with services

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[408] World Bank, "GDP (current US$)", online: https://data.worldbank.org/indicator/NY.GDP.MKTP.CD.
[409] See WTO, *World Trade Report 2018* (Geneva: WTO, 2018).
[410] UNCTAD, Estimates of Global E-Commerce 2019 and Preliminary Assessment of COVID-19 Impact on Online Retail 2020 (2021) UNCTAD Technical Notes on ICT Development No.18.
[411] WTO *supra* note 409 at 38.
[412] Frank Schmidt & Christoph Spengel, "Digital Tax Index 2018: Locational Tax Attractiveness for Digital Business Models", *PWC* (2018) online: https://ftp.zew.de/pub/zew-docs/gutachten/Digital_Tax_Index_2018.pdf.
[413] David Reinsel, John Gantz & John Rydning, "The Digitization of the World from Edge to Core", Int'l Data Corporation (November 2018) online: https://perma.cc/9BFR-RBP5 at 2.

(e.g., food delivery, cab hire, dating, and accommodation) and provide user access to a greater catalogue of consumable content than is available in the pre-digital global economy.[414]

Digitalization enables the emergence of new, highly digitalized business models, capable of delivering a variety of innovative products and services, while also enabling traditional business models to alter and enhance their productivity and delivery.[415] Businesses that considerably exploit these transformative tools are some of the most successful on the global stage. Tech behemoths such as Alibaba, Alphabet (Google), Amazon, Apple, Microsoft, TenCent, and Meta (Facebook) are quick references.[416]

Global economic digitalization also presents a variety of challenges for governments around the world, no less so than in the area of taxation where the phenomenon has upended pre-existing domestic revenue mobilization opportunities and rendered some important international tax norms largely obsolete and ineffective. In the former case, digital services continuously supplant physical products[417] and e-commerce platforms continuously displace local shops and physical business establishments.[418] These changes have accelerated with the COVID-19 pandemic, which caused many businesses to move online or increase their digital integration.[419] Digital displacement reduces a government's tax collection through the closure of tax-paying local

[414] European Commission, *Commission Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services*, (Brussels, EC: 2018) 148 final at 13-20.
[415] See, generally, United Nations Conference on Trade and Development, *Digital Economy Report 2019 Value Creation and Capture: Implications for Developing Countries* (U.N. Doc. UNCTAD/DER/2019).
[416] FXSSI, "Top 10 World's Most Valuable Technology Companies in 2022" (3 February 2022) online: https://perma.cc/Z7VL-ZFUH. There are also many less nominally valuable tech companies that are extremely important to their users for the services that they provide. Examples are Airbnb, Adobe, Didi, Netflix, Spotify, Twitter, Uber, Zoom, etc.
[417] Christopher Mims, "A Surprisingly Long List of Everything Smartphones Replaced," *MIT Technology Review* (22 July 2012), online: https://perma.cc/N3NP-YG5P.
[418] Nathaniel Meyersohn, "American retailers already announced 6,000 store closures this year. That's more than all of last year," *CNN Business* (6 April 2019), online: https://perma.cc/Q2X8-VUDY.
[419] John Koetsier, "97 Executives Say COVID-19 Sped Up Digital Transformation", *Forbes* (10 September 2020) online: https://perma.cc/6TBT-9W9N.

businesses,[420] the neutralization of sales taxes otherwise charged on physical goods,[421] and the elimination of payroll taxes due to local job losses.[422] Global economic digitalization also poses major challenges from a tax administration perspective due to the transformation in business structures and the huge dependence on intellectual property and intangible assets, as well as the vanishment of physical borders between countries.[423]

In the specific context of international taxation, technical limits in the subsisting international tax regime allow for significant base erosion from trade conducted through the digital economy.[424] Non-resident entities operating remotely from one country can leverage digital technology to derive significant income from other countries without having to trigger the thresholds of physical presence (under subsisting international tax rules) that would ordinarily render such income taxable in the source country.[425] As noted in chapter 2, the current international tax rules, which allocate taxing rights between states, were drawn in the early to mid-20th century, long before the

[420] See Vijay Govindarajan *et al,* "The Problem with France's Plan to Tax Digital Companies," *Harvard Business Review* (17 July 2019), online: https://hbr.org/2019/07/the-problem-with-frances-plan-to-tax-digital-companies.
[421] *Ibid.*
[422] *Ibid.* See also Policy Horizons Canada, "The Next Digital Economy" (20 June 2019), online: https://horizons.gc.ca/en/2019/06/20/the-next-digital-economy/ Although digitalization has a diminishing effect on conventional jobs when digital services are delivered remotely, digitalization also has the effect of creating many new jobs; Karim Sabbagh *et al,* "Digitization for Economic Growth and Job Creation: Regional and Industry Perspectives", *World Economic Forum* (2013) online: http://www3.weforum.org/docs/GITR/2013/GITR_Chapter1.2_2013.pdf. The problem in the present case is that those new jobs are largely based overseas, which means that they are outside the tax net of the local authorities.
[423] Association of Chartered Certified Accounts (ACCA), "Technology Tools and the Future of Tax Administration', Research Insight Report" (13 December 2018) online: https://perma.cc/2MSM-TBKG at 12-20.
[424] Rifat Azam, "Global Taxation of Cross-Border E-Commerce Income" (2012) 31:4 Va Tax Rev 639 at 652; Gianni *supra* note 406 at 277.
[425] See Reuven S Avi-Yonah, "Three Steps Forward, One Step Back? Reflections on "Google Taxes" and the Destination-Based Corporate Tax", (2016) 2 Nordic Tax J 69. See Jean-Louis Medus, "Proposals to Regulate Digital Business: Some Critical Comments", (2017) J Int'l Tax 35 ["One main characteristic of digital business is the cross-border dissemination of assets through various jurisdictions and a sort of fragmentation of activities entailing a tax-optimized location of profits and permitting digital companies through treaty shopping to avoid establishing a permanent establishment (PE) (thus subject to taxation) in consumer markets, and to attribute the main part of profits to specific entities and jurisdictions (especially those providing IP (intellectual property)-favorable tax regimes"]; Ana Paula Dourado, "The OECD Report on Pillar One Blueprint and Article 12B in the UN Report" (2021) 49:1 Intertax 1 at 1 ["Enterprises of one contracting state are increasingly providing substantial services to customers in the other contracting state and maintaining a significant economic presence there without having any fixed place of business and without being present in that state for any substantial period of time".].

digital transformation of international trade.[426] Those rules allow a source state to tax only the business profits of a non-resident entity if that entity has a permanent establishment in the source state and derives income through its operations in the permanent establishment.[427] The permanent establishment rule simply does not envisage the taxation of business profits that are derived remotely and, thus, allows such business profits to escape taxation in the source country.[428] A common recognition of these shortfalls in the existing rules has led states to converge to try to develop a framework that addresses the problems of taxing rights allocation in the digital economy.[429]

3.3 A New Global Tax Deal: The OECD BEPS Pillar One Compromise

The tax challenges posed by digitalization have been recognized by states since the e-commerce revolution of the 1990s.[430] However, in the first two decades of those challenges, states took a generally passive approach, perhaps on a presumption that the taxation of cross-border e-commerce would not result in substantial revenue losses for high tax states.[431] This collective attitude changed remarkably after the global financial crisis of 2008, which left the global economy in dire straits.[432] The appetite to reform the international tax rules coalesced around that time. As a result, since 2012 states have gathered mainly on the platform of the OECD, to tackle various international taxation problems, including those directly related to the digital

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[426] Graetz, "Taxing International Income" *supra* note 407; Hentschel *supra* note 8.
[427] See Julie Bellemare, "Evolution of the Permanent Establishment Concept," (2017) 65:3 Canadian Tax J 725.
[428] Gianni *supra* note 406 at 259–260.
[429] Ruth Mason, "The Transformation of International Tax" (2020) 114:3 The Am J Int'l L353.
[430] OECD Committee on Fiscal Affairs*, Clarification on the Application of the Permanent Establishment Definition in E-Commerce: Changes to the Commentary on the Model Tax Convention on Art. 5* (Paris: OECD Publishing, 2000); Jinyan Li, *International Taxation in the Age of Electronic Commerce: A Comparative Study* (Toronto: Canadian Tax Foundation, 2003; OECD, *Implementation of the Ottawa Taxation Framework Conditions: The 2003 Report* (Paris: OECD Publishing, 2003); OECD*, E-Commerce: Transfer Pricing and Business Profits Taxation* (Paris: OECD Publishing, No. 10, 2005).
[431] Arthur J Cockfield, "Tax Wars: How to End the Conflict Over Taxing Global Digital Commerce" (2020) 17:2 Berkeley Bus LJ 347 at 354.
[432] *Ibid.*

economy.[433] The OECD BEPS report of 2015 identifies the digital tax problem as a crucial priority of the modern international tax reform agenda.[434] Action 1 of the BEPS report provides a detailed outline of the tax challenges associated with global economic digitalization.[435] Pursuant to this framework, the OECD has had cause to consider several proposals for taxing the digital economy. These include the significant economic presence (SEP), equalization levy, user participation, and marketing intangibles proposals.[436] Any proposal so considered seeks to identify a new justifiable nexus for the taxation of business profits derived by a non-resident entity through the digital economy, i.e., derived without meeting the existing requirements of the permanent establishment nexus.

Briefly, the SEP nexus would entitle the jurisdiction where users reside to tax the income of a non-resident enterprise where that enterprise has a sustained economic interaction with the jurisdiction through the digital media.[437] Sustained economic interaction may be ascertained by reference to a number of factors, including the amount of revenue derived from the jurisdiction (revenue factors),

[433] See OECD, *Action Plan on Base Erosion and Profit Shifting* (Paris: OECD, 2013). The OECD Base Erosion and Profit Shifting Project (OECD BEPS project) revolves around the central idea of "value creation", the notion that taxes should be paid *where* economic activities take place and, therefore, where value is created. According to Durst, "BEPS refers to the ability of members of multinational groups, under tax laws currently in effect around the world, to divert taxable income from countries where the groups conduct business to other zero- or low-tax countries where the groups may conduct few, if any, activities". Durst *supra* note 20 at 6. Value creation has been adjudged a term of many functions. See Frans Vanistendael, "An Octogenarian on Value Creation" (2018) Tax Notes Int'l 1385; and Werner Haslehner & Marie Lamensch, eds, *Taxation and Value Creation,* EATLP Tax Series vol 9 (Amsterdam: IBFD, 2021). The BEPs project seeks to eradicate the unwholesome practice of some taxpayers shifting their taxable profits to low-tax jurisdictions without a genuine link to the economic activities giving rise to those profits. From an equity standpoint, Christians argues that value creation is squarely a distributive concept that is likely to favor richer countries, in keeping with the distributive patterns of the last century. See Allison Christians, "Taxing According to Value Creation" (2018) 90 Tax Notes Intl 1379.

[434] OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1—2015 Final Report* (Paris: OECD, 2015) ("Action 1 Report").

[435] See Action 1 Report *ibid*; Joachim Englisch, "BEPS Action 1: Digital Economy – EU Law Implications" (2015) 2015:3 BTR 280.

[436] Action 1 Report *supra* note 434; Vidushi Gupta, "How Unified Is the OECD's Unified Approach?" (2019) Tax Notes Int'l 1143.

[437] Daniel Blum, "Permanent Establishments and Action 1 on the Digital Economy of the OECD Base Erosion and Profit Shifting Initiative – The Nexus Criterion Redefined?" (2015) 69:6/7 Bull Int Tax 314 at 105; Gupta *supra* note 436 at 1144.

the extent of engagement with users or user data in the jurisdiction (user-based factors), the engagement with users through digital means, such as a localized domain name, website or digital payment platform (digital-based factor), or any combination of these factors.[438]

The user participation model recognizes that soliciting the sustained engagement and active participation of users is a crucial component of value creation for highly digitalized businesses. The proposal, therefore, regards the users as a sufficient connection between the non-resident, highly digitalized business and the state where those users are located, which, therefore, should entitle the state to tax this value.[439]

The marketing intangibles proposal recognizes that business entities exploit marketing intangibles – as distinct from production intangibles – to penetrate a foreign jurisdiction either remotely or through a limited local presence. This proposal regards the use of marketing intangibles in a foreign jurisdiction as creating an intrinsic link between the entity and the market jurisdiction. This link should, therefore, allow the market state to tax.[440]

The equalization levy is a withholding tax that may be charged on the sales of non-resident digitalized businesses as a means of addressing potential disparities in tax obligations between domestic business and non-resident digitalized businesses.[441] It seems that the objective of the equalization levy lies somewhere in between neutrality and equity.[442]

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[438] See Action 1 Report *supra* note 434 at 106-117.
[439] *Ibid*.
[440] *Ibid*.
[441] *Ibid* at 115.
[442] For an elaborate discussion of these proposals and various others, see Chukwuemeka Stanley Ndibe, "A Review of the Proposals for Taxation of Profits of Businesses in the Digitalized Economy," *University of Western Ontario Master of Laws Research Repository* (2019), online: https://ir.lib.uwo.ca/llmp/5/; Vikram Chand, "Allocation of Taxing Rights in the Digitalized Economy: Assessment of Potential Policy Solutions and Recommendation for a Simplified Residual Profit Split Method" (2019) 47:12 Intertax 1023.

Between 2016 and 2021, more than 130 states (and jurisdictions), under the OECD/G20 Inclusive Framework, were locked in complex negotiations towards a consensus-based global deal that would alter the allocation of international taxing rights to fit the digital economy.[443] The planned alterations would make MNEs liable to tax on profits made in countries where they have significant sales (and possibly users) even without the physical presence (permanent establishment) that is traditionally required.[444] These negotiations progressed until their most concrete stage yet in 2021 when states reached a consensus on such a deal: a "Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy".[445] As at November 2021, no fewer than 137 states (and jurisdictions), representing more than 90% of the global economy, had signed up to the compromise framework.[446] Of the two pillars, Pillar One aims to resolve the tax challenges arising from the digitalization of the economy by altering the existing (physical) nexus and profit allocation rules as they apply to a defined category of MNEs, while Pillar Two aims to limit international tax competition, the so called "race to the bottom", by establishing a global minimum tax rate – eventually 15% – that would ensure that MNEs pay their "fair share" of tax regardless of the tax planning arrangements that they undertake.[447] Although both pillars raise

[443] See OECD, *Tax Challenges Arising from Digitalization—Interim Report 2018:* OECD, *Inclusive Framework on BEPS* (Paris: OECD, 2018); OECD, *Public Consultation Document Secretariat Proposal for a "Unified Approach" Under Pillar One 9 October-12 November 2019* (Paris: OECD, 2019) ["OECD Unified Approach"]; OECD, "Addressing the Tax Challenges of the Digitalization of the Economy—Policy Note: As Approved by the Inclusive Framework on BEPS on 23 January 2019" (2019), online: https://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf; OECD, "Tax and Digitalization," (2018) online: https://www.oecd.org/tax/beps/tax-and-digitalisation-policy-note.pdf; OECD, *Public Consultation Document Addressing the Tax Challenges of the Digitalization of the Economy* (Paris: OECD, 2019); OECD, *Programme of Work To Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy: Inclusive Framework on BEPS* (Paris: OECD, 2019); OECD, *OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors* (Riyadh: OECD, 2020); OECD, *Tax Challenges Arising from Digitalization – Report on Pillar One Blueprint OECD/G20 Base Erosion and Profit Shifting Project* (Pari: OECD, 2020).
[444] See Martin Hearson, "Africa Responds to the Inclusive Framework's Digital Tax Agenda" *ICTD* (7 August 2019) online: https://www.ictd.ac/blog/africa-responds-to-the-inclusive-frameworks-digital-tax-agenda/.
[445] OECD, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2021) [OECD Two-Pillar Solution].
[446] OECD, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD Publishing, October 2021).
[447] *Ibid.*

inter-nation equity concerns, this chapter discusses only the Pillar One aspect of the deal because of its more direct focus on digitalization and its direct objective of taxing rights allocation.[448]

3.3.1 Basic Details

Pillar One aims to adapt international tax rules to the realities of the modern economy, which is highly impacted by digitalization, by allowing "market jurisdictions" (market state or destination state) to tax the profits of MNEs regardless of whether the MNEs maintain a threshold physical presence there. Pillar One has three components, labelled 'Amount A' (a framework for the allocation of taxing rights to market jurisdictions) 'Amount B' (a framework for the allocation of revenue with regard to certain marketing and distribution activities physically occurring in a market jurisdiction) and 'Amount C' (a dispute resolution mechanism for Amount A).

Amount A – the focus of this discussion – provides a basis to tax the "residual profits" (or non-routine profits) of the largest and most profitable MNEs. A specified portion of residual profits of such MNEs would be taxable in the countries where the customers are located or where goods and services are used or consumed, i.e., the "market jurisdictions".[449] Residual profit is defined as profit in excess of 10% of revenue.[450] That portion of an MNE's profit that is allocated to market states as residual profit is referred to as "Amount A". This is distinct from routine or non-residual profits – technically, profits not exceeding 10% of revenue – that remains taxable under

[448] Although there are indirect distributional implications to it, Pillar Two has a mainly efficiency objective of limiting corporate tax avoidance by ensuring that MNEs pay a minimum rate of tax regardless of their tax planning endeavours. For some reflections on the distributional implications of Pillar Two, see, e.g., Noam Noked, "Potential Response to GloBE: Domestic Minimum Taxes In Countries Affected by the Global Minimum Tax" 102:7 Tax Notes Int'l 943; Afton Titus, "Global Minimum Corporate Tax: A Death Knell for African Country Tax Policies?" *SSRN* (2022) online: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3975331; John Vella, Michael P Devereux, & Heydon Wardell-Burrus, "Pillar 2: Rule Order, Incentives, and Tax Competition" (2022) Oxford University for Business Taxation Policy Brief.
[449] OECD Two-Pillar Solution *supra* note 445 at 5.
[450] *Ibid* at 7.

normal business profits taxation rules (i.e., the permanent establishment and arm's length principles).

Amount B has two functions. First, it is intended to enhance simplicity for tax administrators in the administration of transfer pricing rules and to ease compliance costs for taxpayers.[451] Second, it is intended to facilitate tax certainty and limit controversy between tax administrators and taxpayers in the application of transfer pricing rules.[452] To achieve these dual objectives, Amount B will allocate a "fixed return" to related party distributors that perform "baseline marketing and distribution activities" in the market jurisdiction (source country).[453] The market jurisdiction can then tax this fixed return according to its own laws.[454] The fixed return is an arbitrary remuneration rate that is intended to deliver a result that closely mirrors one that is determined in accordance with the arm's length principle.[455] Thus, what is stipulated as a fixed return in each case may be determined with consideration given to the specific industry or region.[456]

Provisions are also made for tax administration, dispute resolution, and double taxation relief, with respect to Amount A. In the first case, provision will be made to ease compliance burdens for MNEs, including allowing an MNE group to manage the process through a single entity.[457] As regards dispute resolution, the deal contains a mandatory and binding dispute prevention and settlement framework that ensures tax certainty for taxpayers. Some low-capacity countries, however, enjoy some elective rights to use the dispute resolution system.[458]

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[451] Pillar One Blueprint *supra* note 443 at 14.
[452] *Ibid.*
[453] *Ibid.*
[454] "The definition of baseline marketing and distribution activities covers distributors that (i) buy from related parties and resell to unrelated parties; and (ii) have a routine distributor functionality profile". *Ibid.*
[455] *Ibid* at 15.
[456] *Ibid.*
[457] OECD Two-Pillar Solution *supra* note 445 at 7.
[458] *Ibid.*

The deal aims to eliminate double taxation on profits allocated to market jurisdictions by using either the credit or exemption method. Credit or exemption will be granted to the entity (or entities) that bears the tax burden, i.e.., the entity that earns residual profit.[459]

By 2022, the OECD plans to produce texts for a Multilateral Convention to implement "Amount A" of Pillar One, as well as Model rules for domestic legislation for the implementation of Pillar One. This is part of a Detailed Implementation Plan that was agreed to fully establish the rules and instruments required to bring the Two-Pillar Solution into effect by 2023.[460]

In terms of revenue output, the OECD expects Pillar One to reallocate taxing rights on more than US$125billion of profit to market jurisdictions each year.[461]

3.3.2 Scope

The residual profit tax regime introduced under Pillar One[462] is intended to apply to "in-scope companies", i.e., MNEs with "global turnover above €20 billion and profitability above 10% (i.e. profit before tax/revenue) calculated using an averaging mechanism."[463] The plan is to reduce the turnover threshold to €10 billion, following a successful implementation of the deal, including the tax certainty provisions on Amount A. A review of the implementation status is stipulated to begin 7 years after the agreement comes into force and should be completed within a year.[464] There is a carveout for companies in Extractives and Regulated Financial Services.[465]

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[459] *Ibid.*
[460] *Ibid.* For an outline of the unfinished parts of the deal, see Jefferson VanderWolk, "OECD Statement on Pillars One and Two Leaves Many Questions Unanswered", *Bloomberg Tax* (13 October 2021) online: https://perma.cc/7D9Z-S6VR.
[461] OECD Two-Pillar Solution *supra* note 445.
[462] All subsequent references to "Pillar One" are references to "Amount A".
[463] OECD Two-Pillar Solution *supra* note 445 at 6.
[464] *Ibid.*
[465] *Ibid* at 7.

The reason given for these exclusions is that the tax policy problems that Pillar One attempts to resolve are not presented by these business models:

> The aim of the Two-Pillar Solution is to make sure that MNEs can't take advantage of the old rules on international tax to avoid paying their fair share and the new rules are designed to capture and address this problem. The exclusions provided for relate to types of profit and activities that are not part of this problem either because the profit is already tied to the place where it is earned (for example, regulated financial services and mining companies will have to have their operations in the place where they earn their income) or the activity benefits from different taxation regimes due to their specific nature (such as shipping companies and pension funds). These types of businesses are still subject to all the other international tax standards on transparency and BEPS to ensure that tax authorities can tax them effectively.[466]

One observation to make here is that an earlier push by some countries was for Pillar One to cover taxation of "digital business models" or "highly digitalised (global) businesses" – mainly Automated Digital Services" (ADS).[467] Other countries favoured a broader scoping that would cover both ADS and "Consumer Facing Businesses" (CFB).[468] The absence of political consensus on this issue hampered a global solution. That idea of business line scoping, which would ringfence "highly digitalised businesses", was eventually jettisoned in favour of the current quantitative scoping model, mainly because of the difficulty of ascertaining what businesses appropriately fall into (or out of) a "highly digitalised businesses" category, in a global economy where almost every business model actively – and increasingly – exploits digital technology.[469] The quantitative scoping model also accounts for the fact that the Pillar One reform has always targeted the most profitable MNEs, those who are often seen as the chief

[466] *Ibid* at 20.
[467] See, for instance, Pillar One Blueprint *supra* note 443 at 10, 11 & 19.
[468] *Ibid* at 11.
[469] Limiting Pillar One to "highly digitalized businesses" might require "ringfencing" the "digitalized businesses" from the rest of the economy even in an era where most businesses, to some extent, exploit digital technology for their purposes. See Gary Clyde Hufbauer, "Dangers Lurking in the OECD Tax Proposals" (2021) Columbia Center on Sustainable Investment Paper No. 303. There is a risk that ringfencing could lead to discrimination between similar businesses. See Young Ran Kim, "Digital Services Tax: A Cross-Border Variation of the Consumption Tax Debate" (2020) 72:1 Ala L Rev 131.

beneficiaries of the global trading system, including the subsisting taxing rights allocation rules.[470]

The broad scoping language of Pillar One leaves a great variety of business types within scope. In February 2022, the OECD provided some pinpoint guidance on the business types that are within scope when it published a consultation document on the Draft Model Rules for Nexus and Revenue Sourcing (2022 Draft Model Rules).[471] The 2022 Draft Model Rules identifies a wide variety of market end business activities that would entitle the market state to tax an MNE's residual profits: location-specific services; advertising services; online intermediation services; transport services; customer reward programs; other business to business (B2B) and business to customer (B2C) services, including financing; license or alienation of intangible property; real property; revenues from government grants; and non-customer revenues.[472] A non-resident entity that earns income from any of these sources would be subject to tax in the market state regardless of whether it has any physical presence there.

The 2022 Draft Model Rules also provide definitional guidance for each of the mentioned activities. For instance, "**advertising service**" is defined as "the provision or facilitation of advertising and includes services for the purchase, storage and distribution of advertising messages, and for advertising monitoring and performance measurement".[473] Advertising service comprises online and non-online forms. The rules do not specify the distinction between the two identified forms of advertising services, but, instead, note that the distinction will be

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[470] See Mustapha Ndajiwo & Learnmore Nyamudzanga, "What Does the G7 Proposal on Taxation of the Digitalised Economy Mean for African Countries?", *APRI* (3 September 2021) online: https://perma.cc/G7JP-N45Q.

[471] OECD, *Public Consultation Document: Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing* (Paris: OECD, 2022) [2022 Draft Model Rules].

[472] *Ibid* at 6-8.

[473] *Ibid* at 28

provided in a forthcoming commentary.[474] However, with regard to non-online advertising, the source indicator rules refer to "advertisements displayed on a billboard or at another fixed site", "advertisements displayed in newspapers, magazines, journals or other publications", and "advertisements displayed on television or broadcast on radio." Thinking by elimination, these references imply that advertisements conveyed through these media do not qualify as "online advertising".

Conversely, there is suggestion that an online advertisement is one that can be viewed[475] as well as "clicked" on.[476] This means that internet-based advertisements that can be clicked on are within scope. There is no mention of internet-based advertisements conveyed by sound, such as those that interject music or podcast streaming. It may be the case that such sound-conveyed advertising services fall out of scope, perhaps, because their mode of conveyance does not provide opportunity for the listener to "click" on the advertisement, which, perhaps, makes it impossible to ascertain consumer response – an apparent requirement for revenue sourcing.

Another important business covered by Pillar One is **online intermediation service.** The 2022 Draft Model Rules defines online intermediation service as "the provision of an online platform to enable users to sell, lease, advertise, display or otherwise offer goods or services to other users provided the revenues derived from the service are dependent on the conclusion of transactions between users of the service." [477] It is also stated that online intermediation service "does not include the online sale of goods and services of the platform's own inventory".[478] Online intermediation service, therefore, provides a platform for third party users to interact and trade

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[474] *Ibid* at 16 ["The Commentary will provide further guidance on the distinction between online advertising and non-online advertising e.g. watching free-to-air television online on a computer.].
[475] *Ibid* at 6 & 9 (referring to number of viewers in each jurisdiction).
[476] *Ibid* at 5.
[477] *Ibid* at 31.
[478] *Ibid*.

in tangible goods, digital goods, digital services, and offline services.[479] Really, online intermediation service functions as an interaction between two business entities and one customer. One business entity, the platform owner/intermediation service provider, combines with another business entity, the third-party supplier, to deliver tangible goods, digital goods, digital services, and offline services to end users or consumers on the platform. In exchange for providing the connection, the first mentioned business entity earns compensation in the form of commission, listing or subscription fees.[480] It is this compensation that is subject to tax in the market state.

The 2022 Draft Model Rules expressly include revenue derived from a transaction for the licensing, sale, or other alienation of **intangible property**, as well as user data, within the scope of Pillar One. It defines "intangible property" as "property which is not in a tangible form and which is capable of being owned or controlled for use in commercial activities but does not include financial assets, digital goods, user data or computer programs that benefit from the protection for computer programs covered by the WIPO Copyright Treaty. It includes copyrights, trademarks, tradenames, logos, designs, patents, know-how and trade secrets."[481] Intangible property may be transacted in several ways. It may be used to support a service; it may be the component of a finished good; or it may be attached to a copyrighted work.[482]

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[479] Three of these four transaction types – digital good, digital service, and offline service – are defined in the 2022 Draft Model Rules. "Digital Good" is defined as "the provision of content through digital means (e.g. music, books, videos, texts, games, applications, computer programmes, software, online newspapers, online libraries and online databases), whether for access one time, a limited period or in perpetuity". "Digital Service" is "a service that is provided over the internet or an electronic network, including streaming, gaming or other services for accessing online content but does not include Digital Goods". "Offline Service" is "a service that is not delivered over the internet or an electronic network, irrespective of the manner in which that service was procured and includes the supply of personal or business accommodations or premises, on a short-term or long-term basis." Examples include: hotel, apartment and house accommodations, taxi services, food delivery. See 2022 Draft Model Rules *ibid* at 27, 30, & 32 respectively.
[480] OECD Pillar One Blueprint *supra* note 443 at 28.
[481] 2022 Draft Model Rules *supra* note 471 at 35.
[482] *Ibid* at 24–25.

In addition to the services that are specifically mentioned, the 2022 Draft Model Rules also makes a general inclusion of **B2B** and **B2C services** within the scope of Pillar One. B2B service is defined as a service that is provided to a business customer, apart from transactions in intangible property.[483] An example is a cloud computing service that is provided by an MNE to another entity for the latter's use as part of its business. B2C service is simply defined as a service that is provided to consumers.[484] It would include, for instance, CFBs, i.e., a type of business where an MNE generates revenue from the sale of goods or services of a type commonly sold to consumers, in this sense, to individuals (end users) that purchase items for personal use and not for commercial or professional purposes.[485]

3.3.3 Nexus

In a limited deviation from traditional nexus rules, Pillar One creates a new "special purpose nexus rule" that permits allocation of taxing rights to a market jurisdiction (sales-based), with respect to Amount A, regardless of the (non)existence of a permanent establishment. However, the nexus is qualified by a threshold that limits the right of a market state to tax the profits of an in-scope MNE to only situations where the MNE derives revenue of at least €1 million from that state. This threshold is lowered to €250,000 for "smaller jurisdictions", i.e., jurisdictions with GDP lower than 40 billion euros.[486] The special purpose nexus rule applies only for the purpose of determining whether a jurisdiction qualifies for the Amount A allocation.[487] It is implied that the purpose of the thresholds is to limit compliance costs, especially for MNEs, as well as for

[483] *Ibid* at 29.
[484] *Ibid.*
[485] OECD Pillar One Blueprint *supra* note 443 at 37.
[486] OECD Two-Pillar Solution *supra* note 445.
[487] *Ibid.*

tax authorities who may, otherwise, have to expend limited resources tracing small amounts of sales.[488]

3.3.4 Profit Allocation

Pillar One specifies that 25% of the "residual profit" – i.e., profit in excess of 10% of revenue – will be split among market jurisdictions. Each market jurisdiction would be allocated a share of the MNE's residual profit that is proportionate to the quantum of overall revenue that is sourced from that jurisdiction.[489]

3.3.5 Revenue Sourcing

Profit is allocated to a market jurisdiction based on the quantum of an MNE's revenue that is sourced from that jurisdiction. It is, therefore, necessary to develop sound methodologies for sourcing income to the specific market jurisdictions where the goods or services supplied by an MNE are sold to customers. The OECD recognizes that sourcing functions need to be performed by the in-scope MNE, based on the factual nature of its business. For this reason, Pillar One includes a mandate for development of "detailed source rules for specific categories of transactions".[490] The rules will require an in-scope MNE that is applying them to use a "reliable method" that is based on "the MNE's specific facts and circumstances".[491]

In accordance with this mandate, detailed sourcing rules are now provided in the 2022 Draft Model Rules. The rules define "revenue" as "the Total Revenues of a Group after the exclusion of Revenues derived from Extractive and Regulated Financial Services."[492] "Total Revenues"

[488] *Ibid.*
[489] *Ibid.*
[490] *Ibid* at 6.
[491] *Ibid.* The dispute resolution mechanism embedded in the framework might become relevant in resolving potential conflicts that arise between MNEs and tax authorities on the proper application of sourcing rules: e.g., whether the right source methods have been selected or whether the selected methods have been properly applied.
[492] OECD Draft Model Rules 2022 *supra* note 471 at 5.

refers to "the Revenues reported in the MNE's Group Consolidated Financial Statements prepared in accordance with an Acceptable Financial Accounting Standard, after applying the agreed adjustments to the tax base, as relevant".[493]

The Draft Model Rules contains distinct revenue sourcing rules for different types of income yielding activity. For instance, in the case of finished goods sold to a final customer, the market jurisdiction is the place where the finished goods are delivered.[494] Closely related to finished goods, in the case of revenue derived from a transaction for the sale of components, the market jurisdiction is the place of delivery of the finished good that embodies the component.[495] For online advertising, revenue is sourced to the jurisdiction where the viewer of the advertisement is located.[496] For online intermediation services that facilitate the sale or purchase of tangible goods, digital goods or digital services, the revenue is split in equal half between the location of the purchaser and the seller of the goods or services that are sold via the intermediation platform.[497] This means that where the purchaser and the seller are located in one state, that state becomes the sole market jurisdiction, entitled to tax the entire market-allocated profit. For intangible property, the sourcing requirements differ according to circumstance. Where the intangible property supports the provision of a service, the market jurisdiction is the place of use of the service.[498] In other cases, the market jurisdiction is the place of use of the intangible

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[493] *Ibid* at 5. A component of the draft Pillar One model rules that deals with tax base determination was released in February 2022. See OECD, *Pillar One – Amount A: Draft Model Rules for Tax Base Determinations* (Paris: OECD Publishing, 2022) at 3 ["The Model Rules on Tax Base are designed to calculate the profit (or loss) of a Covered Group that will be used for Amount A calculation purposes. The tax base is therefore the measure of profit that forms the basis for partial reallocation under Amount A rules. Given that Amount A is a new taxing right that is determined based on the profits of a group (rather than on a separate entity basis), it is necessary to use consolidated group financial accounts as the starting point for computing the Amount A tax base. This approach also has the advantage that the Amount A tax base is less affected by controlled transactions."]
[494] OECD Draft Model Rules 2022 *supra* note 471 at 6 & 12–13.
[495] *Ibid* at 6 & 15.
[496] *Ibid* at 7 & 16-17.
[497] *Ibid* at 7 & 17-18.
[498] *Ibid* at 8 & 23–24.

property by the final customer.[499] Revenue derived from the licensing, sale or other alienation of user data is sourced to the jurisdiction where the user associated with the data is located.[500] There are similar destination-based sourcing rules for transport services, customer reward programs, the provision of financing and other non-specified B2B and B2C services, real property, government grants, and non-customer revenues.[501]

3.4 Evaluation of the OECD Pillar One Compromise

Every international tax compromise that allocates taxing rights arouses concerns of inter-nation equity. The same assessment can be made of the evolving multilateral compromise on Pillar One. As I referenced in the previous section, Pillar One has been accepted as a compromise by nearly 140 states (and jurisdictions), constituting over 90% of the world economy. However, there are still noticeable agitations about its distributional fairness, especially to LIDCs and, consequent to that, a few Inclusive Framework participating states, Kenya, Nigeria, Pakistan, and Sri Lanka, have shown reluctance to endorse the deal.[502] In view of the fairness questions trailing Pillar One, this section undertakes an equity-based evaluation of the compromise, as presently constituted, using the RIC framework. The first question that I address is whether and when an LIDC has jurisdiction to tax the income of an MNE that is derived from that MNE's participation in the digital economy, i.e., without a physical presence in the taxing state. The second question is whether the Pillar One compromise impairs or has the potential to impair the tax jurisdiction of LIDCs. Finally, this section addresses the reasonableness of any adjudged impairment that the compromise imposes on the tax jurisdiction of LIDCs.

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[499] *Ibid.*
[500] *Ibid* at 8 & 25.
[501] See, generally, OECD Draft Model Rules 2022 *ibid* at 7–8.
[502] Carlos Mureithi, "Why Kenya and Nigeria Haven't Agreed to a Historic Global Corporate Tax Deal", *Quartz Africa* (2 November 2021) online: https://perma.cc/95AR-8ADE.

3.4.1 Jurisdiction to Tax the Income of Non-Residents in the Digital Economy

Pillar One proposes to recognize a new form of taxing rights for the market jurisdiction on top of the existing nexus and profit allocation rules that rely on activities taking place through a physical presence in a jurisdiction.[503] The idea underlying this proposition is that the location of sales, i.e., the market jurisdiction, contributes to value creation for MNEs.[504] This conceptualization has sparked scholarly debate over whether there is normative justification for the proposed new taxing right.[505] It seems to me that there are two interconnected issues at play here. The first is whether the concept of market jurisdiction is a new form of tax jurisdiction that is unique or distinct from existing conceptualization of source tax jurisdiction. The second borders on the nature of activities that can be deemed to create a justifiable nexus for a state to tax as a market jurisdiction.

In my view, the first issue is relatively straightforward. The often-called "new taxing right"[506] does not require a unique form of theoretical justification. This is because it hinges on well-established grounds of tax jurisdiction: economic allegiance (mainly) and the benefits principle, both of which intersect with the newer concept of value creation.[507] As far as economic allegiance

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[503] OECD Pillar One Blueprint *supra* note 443 at 13.

[504] Victoria Plenkhanova, "Value Creation within Multinational Platform Firms: A Challenge for the International Corporate Tax System" (2020) 17:2 eJournal of Tax Res 280.

[505] See, e.g., Dourado *supra* note 425 at 4 and Svitlana Buriak, "A New Taxing Right for the Market Jurisdiction: Where Are the Limits?" (2020) 48:3 Intertax 301 at 305 [both contending that value creation is not a sound principle for justifying the allocation of taxing rights to a market state because the principle is only suitable for determining the functions, assets and risks performed or deployed by different segments of an MNE's business, i.e., for transfer pricing purposes.].

[506] See Buriak *ibid* at 303. See also, Lorraine Eden, "Canada and the United States: Winners or Losers from Pillar One Amount A?" 50 TMIJ 1, [highlighting a split of international tax jurisdiction into three forms – residence (home), source (host) and market (sales destination) states jurisdiction – by the introduction of Pillar One].

[507] See Li, Bao & Li, *supra* note 142 [Asserting that value creation is a modern extension of the concept of economic allegiance, which has predominated international taxing rights allocation for over a century, which means that it has the potential to impact taxing rights allocation.

goes, the 1923 Report remains unimpeached in its recognition of the market as a vital component of the origin of income and, therefore, a basis for taxation:

> In the attempt to discover the true meaning of economic allegiance, it is clear that there are three fundamental considerations: that of (i) production of wealth; that of (2) possession of wealth; that of (3) disposition of wealth… By production of wealth we mean all the stages which are involved up to the point of the wealth coming to fruition, that is, all the stages up to the point when the physical production has reached a complete economic destination and can be acquired as wealth. The oranges upon the trees in California are not acquired wealth until they are picked, and not even at that stage until they are packed, and not even at that stage *until they are transported to the place where demand exists and until they are put where the consumer can use them*. These stages, up to the point where wealth reaches fruition, may be shared in by different territorial authorities.[508]

The language used by the four economists in the fundamental 1923 Report leaves no doubt as to the relevance of the market jurisdiction nexus. Clearly the production of wealth involves both the supply side (manufacturing, production, and transportation to the market) and the demand side (purchase and consumption).[509] The production of wealth can be broken into four segments: (1) the on-site production input; (2) the high-level entrepreneurial input; (3) the transportation of good or service between stages of production; and (4) the sale of good or services at the end market.[510] It is emphatically stated that "no one of these four elements can be omitted without ruining the efforts of the other three and spoiling the whole apparatus for the production of wealth."[511] The state where customers are located is an integral part of the wealth creation chain, such that without the customer base, the non-resident entity's goods or services bear no economic value whatsoever.[512] After all, there might be no market for a product in its country of design,

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[508] See 1923 report *supra* note 144 at 22–23.
[509] Craig Elliffe, "Submission on the Proposed "Unified Approach" to Pillar One", *SSRN* (2019) online: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3513034.
[510] 1923 Report *supra* note 144 at 23–24.
[511] *Ibid.*
[512] Schon *supra* note 407 at 285.

but a great market for it elsewhere.[513] It is, therefore, beyond doubt that the concept of market jurisdiction, being a component of source jurisdiction, is not nascent. It follows a constant underlying principle that a sovereign state is entitled to tax all persons, activities, or things that are within its territory.[514] I am of the firm view that these original principles contemplate taxation by a state in whose territory the sale/use of goods or services occur (market jurisdiction), since such sale/use can be deemed to contribute to the creation of wealth for the responsible enterprise, regardless of that enterprise's physical location.[515]

However, as I have also been keen to espouse, the underlying principles of tax jurisdiction are not always identical with the nexus thresholds that states establish for the actual exercise of tax jurisdiction. This is certainly the case with regard to the taxation of business profits of a non-resident entity. Largely for reasons of political feasibility and administrative convenience, states established a compromise that has, historically, limited a source state's exercise of tax jurisdiction to only those situations where wealth creating activities are carried out through a physical nexus, i.e., a permanent establishment or fixed base.[516] States also agreed – and reaffirmed – that only production activities on the supply side would ground the exercise of source tax jurisdiction.[517] Naturally, this compromise eliminated market-based or demand side activities as an *active* component of the exercise of source tax jurisdiction. Such a compromise made sense in the brick-and-mortar economy when significant cross-border economic activities were mostly carried out through some form of physical engagement with the foreign source

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[513] Jonatan Kanervo, "Allocation of taxing rights in international corporate income taxation Comparing the current system, residual profit allocation, and OECD Pillar One" (2021) University of Helsinki LLM Thesis at 35.
[514] Michael Kobetsky, *International Taxation of Permanent Establishments: Principles and Policy* (Cambridge: Cambridge University Press, 2011) at 23 ["There is a general agreement among commentators that a sovereign country has almost unlimited fiscal jurisdiction"].
[515] See 1923 report *supra* note 144.
[516] See Wang *supra* note 145; Harris & Oliver *supra* note 130.
[517] Chand *supra* note 442.

country. Those were the pre-digitalization years. In my view, even though digitalization has transformed the landscape of cross-border economic engagement, allowing for significant economic activities to undermine the established physical nexus, no such violence is done to the original underlying principles of tax jurisdiction. Therefore, the notion that Pillar One "creates" a new taxing right is correct only to the extent that Pillar One revives the exercise of an aspect of source tax jurisdiction – the market jurisdiction – that has been left dormant. It does not warrant a reimagination of the underlying economic-political logic of jurisdiction, as Vella & Devereux rightly observe:

> The income being allocated among countries owes as much to the market as it owes to the various parts of the supply chain. Income depends on the price charged at the point where supply and demand meet: it simply would not have arisen in the absence of a market. It is not entirely clear why the international corporate tax system should depart from a simple and uncontroversial economic understanding of value creation.[518]

Accordingly, the only factor that stands to change is the way that states choose to apply the original/underlying principles of tax jurisdiction, i.e., the thresholds that they choose to abide by. In the era of digitalization, it does not seem sensible for states to continue to ignore the demand side of wealth creation when asserting tax jurisdiction. Even the U.S. Supreme Court has declared in recent time that keeping a rule that exempts out-of-state vendors from collecting and remitting sales tax on their in-state sales because the vendors themselves do not maintain a physical presence in the state has become unsound and progressively "becomes removed from economic reality" when one considers the technological changes that now exist.[519]

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[518] Michael P Devereux & John Vella, "Taxing the Digitalised Economy: Targeted or System-Wide Reform?" (2018) 2018:4 BTR 387 at 394.
[519] *South Dakota v Wayfair Inc* (2018) 138 S. Ct. 2080.

Thus, the incorporation of "market jurisdiction" merely reflects a readjustment of the compromise nexus thresholds that states perceive as sensible for the exercise of source tax jurisdiction rather than a shift in the underlying principles which they understand as conferring the right to tax.[520] The pervasive shift from the traditional physical presence nexus to a demand-side, market-based or destination-based nexus reflects states' discontent with the emergent distributional implications of the former[521] and, therefore, a reaffirmation of the market engagement (in-bound sales conducted remotely through digitalized means) as sufficient nexus for taxation.[522] This shift of approach is backed by another well-established theoretical justification: the benefit principle.[523] It has been said, on this point, that "market jurisdictions" provide service to MNEs through maintaining a market for the goods and services of MNEs, which, thus, entitles the state to tax a portion of the MNE's market-based (not entire) profit.[524] Market-based profit is said to derive from an MNE taking advantage of the market that is maintained by governments through investing in the legal, physical, digital and other infrastructures.[525] While an MNE may not be physically present in a state, it is able to project itself into the economic life of that state through the digital infrastructure and user market that are maintained there, which it exploits for profit.[526] In support of the benefit principle as a basis for source state taxation in the digital

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[520] For a review of the many tax strategies that states are using to capture the revenue that is derived by MNEs in the modern economy, see Allison Christians & Tarcisio Diniz Magalhaes, "The Rise of Cooperative Surplus Taxation" *SSRN* (2020) online: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3687011.
[521] Lilian V. Faulhaber, "Taxing Tech: The Future of Digital Taxation" (2019) 39:2 Va Tax Rev 145.
[522] Many countries, including Austria, Canada, France, Hungary, India, Italy, Kenya, New Zealand, Sierra Leone, Spain, Tunisia, Turkey, and the United Kingdom, have proposed or adopted a DST, which indicates widespread approval of "non-physical" trading as sufficient nexus for taxation. See KPMG, "Taxation of the Digitalized Economy: Direct Taxes", *KPMG Tax* (5 February 2020) online: https://perma.cc/US9K-RWRA; Elke Asen, "What European OECD Countries Are Doing About Digital Services Taxes", *Tax Foundation* (25 March 2021) online: https://taxfoundation.org/digital-tax-europe-2020/.
[523] See Johannes Becker & Joachim Englisch, "Taxing Where Value Is Created: What's 'User Involvement' Got to Do with It?" (2019) 47:2 Intertax 161.
[524] Chatel & Li *supra* note _ at 13.
[525] *Ibid* at 14.
[526] Chand *supra* note 442 at 1027.

economy, Cai & Li argue that "a market jurisdiction can, by all means, tax foreign exporting companies on the grounds that those companies benefit from its market accesses".[527] Likewise, Elliffe identifies five major perspectives of source country contribution to the conduct of digitalized business in its territory:

- the contribution to the business environment and economy: this includes the general business confidence, corruption and law and order, affluence and ability to consume. Often goods and services purchased by a resident in the source country are then consumed either in the production of further business activities (requiring a viable fiscal environment) or in private consumption (requiring a consumer with spending power);
- the contribution to the technological infrastructure: this includes suitable telecommunications infrastructure, Wi-Fi and broadband, and a population with appropriate devices (computers and smartphones);
- the contribution to the legal system: this includes providing reliance to enforce payment for transactions, uphold intellectual property rights (such as trademarks), and maintain a competitive and conducive business environment. The protection of intellectual property rights (for example in the case of computer software) is critical to vendors of intangible products and digitalised services. The ability to deal with fraudulent and criminal behaviour is also important as are consumer protection laws;
- the contribution to infrastructure: modern infrastructure to allow physical delivery of goods in a timely and protected way, provision for waste disposal for packaging materials;
- the contribution of users to the digital business: this may take many forms but include the role of users and social media (designing or providing content), the contribution individuals make to the network effect (family, followers and friends), the provision of assets and services as part of the sharing economy (either physically located or physically performed in the source jurisdiction), the process of review, validation and assessment (on services or goods), etc.[528]

I am in concurrence with these positions. I also point out that even the four economists, although they ultimately settled on the broader concept of economic allegiance, also implicitly endorsed the benefit principle when they raised the question: "how, then, should the sum that he finally

[527] Qiang Cai & Xiaorong Li, "The New Taxing Right and Its Scope Limitations: A Theoretical Reflection" (2021) 49:3 Intertax 210 at 215.
[528] Elliffe *supra* note 509, citing Dale Pinto, *E-Commerce and Source-based Income Taxation* (Amsterdam: IBFD Publications, 2003) at 22–23.

pays reach these several governments *which render him service*?"[529] I would also add, however, that the existence of discernible benefits provided the non-resident by the market state is not a prerequisite for the market state to tax outbound income.[530] The mere existence of some form of economic allegiance would suffice.

The second question – whether a particular activity that can be deemed to create a justifiable nexus for taxation as a market state – is more controversial and requires both qualitative and quantitative analyses. It requires some examination of the type of activity that is taking place and the degree of its existence that would justify the market state asserting the right to tax. This question is especially relevant with regard to the taxation of business income that hinges on the participation of users – as against sale to customers – in the wealth creation process of MNEs. For instance, from a qualitative angle, one might ask whether a state should be entitled to tax revenue from online advertising viewed by its residents when it is a non-resident third-party – rather than those residents – that pays for the advertising. Quantitatively, one might ask whether any sort of user data collection from a jurisdiction creates justifiable nexus for the exercise of taxing rights or whether it only makes sense to tax if the MNE has a "sustained engagement" with users in the state and does commercially exploit the collected data.

I should emphasize that my venture into this issue is, as far as Pillar One is concerned, academic. This is because of the broad scope of business activities that Pillar One covers. Because Pillar One applies to all business models – beside the extractive industry and regulated financial services carveouts – it seems implicit that all business models qualify for residual profits reallocation, provided that they also meet the other scoping requirements. My view is that such

[529] 1923 Report *supra* note 144 at 20.
[530] Cai & Li *supra* note 527 at 215.

a wholesale application of Pillar One may in some cases be inconsistent with the concept of market jurisdiction, as envisaged in the 1923 Report. It seems to me that what was contemplated as market jurisdiction is jurisdiction based upon the location of sale/consumption of goods or services. This connotes some incorporation of destination principle.[531] It seems that market jurisdiction, as an aspect of origin or source jurisdiction, is conceptually limited to the location of sale to customers rather than the place where supply side activities take place. Therefore, in the context of digitalization, the right to tax as a market state should only accrue to a state where the sale/consumption of goods or services (supplied through the medium or with the facilitation of digitalization) is located. This 'narrow' view of market jurisdiction does not seem to accord with the scope of Pillar One. Instead, Pillar One appears to contemplate a broader view of market jurisdiction which incorporates the user jurisdiction.[532]

To use a few examples, starting on the affirmative side, it seems sensible to attribute market-based taxing rights to a state where an MNE derives revenue from the provision of online intermediation services. The revenue earned from this service is sourced from end users of the platform who make purchases of goods or services sold on the platform from third parties. In this case, the MNE's revenue, whether as commission, listing or subscription fees, derives from payments by end users or customers on the platform. Therefore, the state where those users or customers are located can rightly be regarded as the market state.

Similarly, I reason that market-based taxing rights allocation rightly attaches to the taxation of income derived from the trade of intangible property to residents of a state, as the 2022 Draft

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[531] This explains the evolved perception that even though the Pillar One reform project commenced on a footing of value creation, there has been a shift from the "value creation approach", in which profits are taxed where value is created to a "destination-based approach", whereby taxing rights are allocated based on the size of consumers' markets. See Daljit Kaur & David Watkins, "Asia-Pacific's Response to the Proposed OECD Reforms", *Int'l Tax Review* (23 April 2020) online: https://perma.cc/2F7P-CYLA.

[532] Perhaps, it is in this limited respect that we can concede that Pillar One creates a new form of taxing right.

Model Rules contemplate.[533] This is because revenue is sourced to the location of use of the intangible property by the MNE's final customers.[534] Payment for the intangible property would in such situations, be ordinarily attributable to the final customers who are resident in the market state. Therefore, the taxing right of the market state is discernible.

The same logic applies to the sale of finished goods or components of finished goods. In either case, the tax base (revenue) is traceable to the place of delivery, which is deemed the location of the final customer paying for the good or component. It, therefore, makes sense that the state where that final customer is located – i.e., where the good or component is delivered – is entitled to tax the outbound revenue, as a market state.

In each of the foregoing cases, tax nexus is established by the presence or participation of the non-resident MNE in the economic life of the market state through the sale of goods or services to customers located there.[535] All that may then be settled (by unilateral or negotiated compromise) is the question of how much of a presence (threshold) should exist before the market state can exercise its vested tax jurisdiction. Some thinkers would say that the economic presence should be "significant" or "sustained".[536] Others assert that the market state should exercise jurisdiction only when the non-resident MNE "actively intervenes and benefits from that state's infrastructure in order to create value for itself."[537]

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[533] 2022 Model Draft Rules *supra* note _ at 23–25.
[534] *Ibid.*
[535] See Cai & Li *supra* note 527 at 215.
[536] This is, perhaps, why a "significant economic presence" test features in the digital tax regimes of some states, as well as in the conceptualization of tax market states' tax jurisdiction in the Pillar One framework. See, e.g., OECD "Unified Approach" *supra* note 443. See also Cai & Li *ibid* at 215–216 [arguing that the requirement of a sustained and significant economic presence is not a prerequisite for a market jurisdiction taxation – nor is a PE under Article 7 –because market access is sufficient to ground tax jurisdiction in the source state. However, requirements for significant and sustained benefits provided by the state to the MNE are necessary for tax nexus for other policy reasons: to ensure that tax jurisdiction is not expanded indefinitely, which may cause the international tax system to collapse].
[537] Chand *supra* note 442 at 1027.

I am less convinced about the vesting of market-based jurisdiction with respect to activities such as online advertising service and the license or transfer of user data – to the extent that both predicate nexus on user participation alone. The sourcing rules of Pillar One attribute revenue from online advertising service to the state where the viewer of advertisement is located.[538] However, it is not the viewers of advertisement that pay for advertisement service. Rather it is a third-party customer, usually another business entity, that pays the MNE (digital platform operator) to advertise its products or services to users of the platform (viewers). The advertising customer, like the MNE, *may* be located in a state that is entirely different from the users/viewers. For this reason, I am of the view that it is the state where the advertising service customer is located, from where payments for advertising service emanate, that may be properly termed the "market jurisdiction". It is a customer located in that state that the MNE markets its advertising service to and receives taxable compensation from.

So, what could be the rationale for sourcing revenue from advertising to the jurisdiction where viewers are located rather than where the customer is located? Online advertising is often tailored to fit the interests, preferences, routines, and choices of its targeted viewers.[539] This increases the potential that viewers would click on the advertisement and, therefore, access the products and services advertised. Such precise advertising is achievable when the MNE (advertiser) is able to collect and utilize the data of its users, as they interface with its digital platform (e.g., social media platforms and search engines).[540] It is for this reason that states and jurisdictions like the United Kingdom and the European Union during the OECD Pillar One reform process advocated the attribution of taxing rights to states where users reside under the user participation

[538] 2022 Draft Model Rules *supra* note 471 at 7 & 16–17.
[539] New America, "The Role of Data in the Targeted Advertising Industry", *New America,* online: https://perma.cc/YAF3-YE2A.
[540] See Buriak *supra* note 505 at 309–310.

proposal.[541] The user participation proposal became one of the metrics by which the OECD gauges the attributability of taxing rights to a "market state".[542]

However, the fact that an MNE manages to collect troves of data from users of its platform and exploits that data to tailor their advertising viewership does not make them (users/viewers) customers of the MNE. Rather, as stated above, the advertising arrangement is between the MNE and a third-party customer which pays to advertise its products or services, and which may not share a common location with the viewers of advertisements. It, therefore, does not seem entirely logical to attribute market-based taxing rights to the state where the users/viewers are located.

I should stress that I do not contend that the state where viewers of advertisement reside is entirely bereft of basis to tax online advertising revenue. I am only not convinced that such a state can be characterized as a "market jurisdiction". Undoubtedly, user data has become a valuable resource for online advertising companies.[543] For this reason, it is arguable that user data can be treated as a resource of commercial value, which is integral to the value chain of

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[541] See HMRC, "Corporate Tax and the Digital Economy: Position Paper" (2017) online: https://perma.cc/WZ2N-J8PG; European Commission, *Proposal for a Council Directive Laying Down Rules to the Corporate Taxation of a Significant Digital Presence* (Brussels: EC, 2018); Itai Grinberg, "User Participation in Value Creation" (2018) 2018:4 BTR 407.

[542] See, generally, OECD Unified Approach *supra* note 443; OECD Pillar One Blueprint *supra* note 443; 2022 Model Draft Rules *supra* note _. For an in-depth analysis of the user participation proposal, see Grinberg *ibid* [arguing that user participation does not justify a change in the taxing right allocation rules especially as the collection of user data does not create any unique value for so-called digital business models that it should ground a taxing right in the data origin state. Grinberg reckons that such data collection is an integral part of the way some businesses operate even prior to the emergence of digital trade. The author cites the fitting example of data collection by pharmaceutical companies from participants in drug trials, noting that such firms are never taxed on the basis of their data collection activities. I can only respond by stating that the fact that something has not been done does not mean that it cannot be done. Neither does it mean that there is no basis to do it. The policy of a state not to place a tax cost on data collected by non-resident pharmaceutical companies is a matter of sovereign choice which, I believe, can be reversed if the state forms the opinion that data collection constitutes economic value which warrants some form of taxation. Such a change in perspective may not be detached from the radical shift in the intensity of user data cultivation and exploitation between the pre- and post-digitalization eras. User data collection and exploitation ceased to be a thing that a state would turn its tax eye from.].

[543] Scott Goodson, "If You're Not Paying for It, You Become The Product", *Forbes* (5 March 2012) online: https://perma.cc/Z96R-CQEH; Josh Constine, "You're Not Just The Product, You're The Ads (And Your Friends Should Thank You)", *TechCrunch* (11 October 2013) online: https://perma.cc/L63A-5Q4P. Buriak *supra* note 505 at 309–310.

online advertisers. It is also arguable that a state from where user data is collected is a source state, i.e., a state that contributes to wealth creation for the MNE by providing a resource of value.[544] This is especially so in a situation of "sustained user relationship" which can be harnessed consistently for data mining.[545]

Ideally, perhaps, user data should be treated as a unique resource, somewhat like extractives or agricultural produce (like the classic example of the oranges picked in California), but with understanding that not all the data that an MNE harvests would ultimately be commercially utilizable.[546] Therefore, a compromise may be formed at a juncture that enables the data origin state to tax the resource only in the case of exploitation. Where the MNE exploits the resource to enhance its own products or services, for instance, the data origin state may be entitled to tax a proportionate share of the MNE's income, since the data is, inferably, a contributor to value creation for the MNE.[547] On the other hand, where exploitation takes the form of third-party

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[544] See Wei Cui, "The Digital Services Tax: A Conceptual Defence" (2019) 73:1 Tax L Rev 69.

[545] Becker & Englisch *supra* note 523 at 171 ["the creation and maintenance of user networks can be crucial for the intermediation services rendered by certain digital platform operators (e.g. Uber, Airbnb in the sharing economy, Amazon Marketplace in the commercial sector). The authors have argued that such stable user networks and similar groups of users are therefore equivalent to a productive (and potentially marketable) intangible asset that could lend itself to creating nexus for source based taxation".]. The so-called "marketing intangibles" theory features prominently in the OECD's consideration for establishing tax jurisdiction in the modern economy. Marketing intangibles is an extended version of the user participation concept in that it applies beyond digitalized business models operating remotely or through a limited local presence structure. The theory emphasizes the 'functional link' between an MNE's marketing intangibles and the market jurisdiction. It relies on the notion that intangible assets such as brand name are developed in the market state and "reflected in the favorable attitudes in the minds of customers. Secondly, that customer data, customer list, relationships are "derived from activities targeted at customers and users in market jurisdiction". See OECD, *Public Consultation Document: Addressing the Tax Challenges of the Digitalization of the Economy* (Paris: OECD Publishing, 2019) at 11–12; OECD 'Unified Approach' *supra* note 443.

[546] Buriak *supra* note 505 at 310.

[547] This would inevitably (re)ignite debate over whether and to what extent user data or user participation contributes value to the MNE's business. See Becker & Englisch *supra* note 523 [arguing that user participation should only create a taxable nexus where there is 'stable' or sustained user relationship between the MNE and the customer base and where such customer base is used by the MNE for business purposes]. Buriak argues that users are, generally, unlikely to be significant contributors to wealth creation, which means that the data source state should not be entitled to tax an MNE's income on this basis. However, the author argues that when "income-generating data" is collected from consumers and utilized by a firm for delivery of targeted advertisement, the market jurisdiction where the consumers are located should also be regarded as the place of origin of income "since the main input of wealth production is extracted there. See Buriak *supra* note 505 at 309. Buriak further argues that data collection is merely a

advertisement, taxation could mean, like Pillar One, taxing the fees earned by the advertiser, not as a market state, but as a supply side state. This achieves the same purpose envisioned in Pillar One without mischaracterizing the taxing state as a market jurisdiction. Importantly, this also preserves the right of the actual market jurisdiction – the state where the online advertising customer is located – to tax as such. In each of these cases, the overarching idea of economic allegiance – or origin, as a subset – is maintained.

In the same vein, where a non-resident MNE harvested user data, through its digital platform operated in a state, and then trades that data to a customer, it seems implicit that the data cache is a resource of commercial value to the transacting MNE and the data origin state should, therefore, be entitled to a share of the revenue derived from the trade. To my mind, the data origin state does not qualify as a market jurisdiction, contrary to the implication of Pillar One,[548] unless where data is sold to a person in that state. Nevertheless, the data origin state retains a right to tax the MNE's revenue as a pre-market source state. In the case where data is sold elsewhere, the data origin state is, in my view, a supply-side source jurisdiction but not a market jurisdiction. The tax imposed on the data sale revenue, for instance, may be more appropriately characterized as a data "collection" levy.

Perhaps, it may be argued in the alternative that an arrangement for advertising service between an MNE and its paying customer is not complete until the advertising service is delivered. Therefore, the state where the advertising service is delivered – i.e., where viewers are located – can be regarded as a market state.[549] This is also a plausible, yet more remote sentiment, since

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"supportive auxiliary function" for companies that do not perform targeted advertisement and data trading, and, therefore, should not warrant the attribution of taxing rights to the market jurisdiction. See *ibid* at 310.

[548] See 2022 Draft Model Rules *supra* note 471 at 25 ["Revenues derived from a transaction for licensing, sale, or other alienation of user data are deemed to arise in [a Jurisdiction] when the Location of the User that is the subject of the data being transferred is in [a Jurisdiction].

[549] Perhaps, jointly with or in addition to the state where the purchaser of the service is located.

viewers do not pay for advertisement. I am less inclined to embrace the idea that mere delivery of advertising service without the concomitant flow of payment from the person to whom the advertisement is delivered, or their privy in interest, qualifies the state of delivery as a market state and, therefore, confers upon that state a right to tax as such.

In sum, it remains a solid principle that a state's right to tax is an attribute of its sovereignty over all taxable factors within its territory. Digitalization radically expands the capacity of a non-resident entity to engage in economic activities in a state without meeting the set nexus thresholds for taxation and, to that extent, triggers a strong response by source states to reaffirm and reassert their sovereign tax jurisdiction. If we remain faithful to the original (pre-compromise) principles of tax jurisdiction, as well articulated in the 1923 Report, we will easily conclude that an LIDC, like any state, is entitled to tax income derived by a non-resident entity from engagement in economic activities in the LIDC. This fundamental position abides even if the non-resident entity engages remotely through a digital platform or merely carries out market activities such as sale of goods and services, without establishing a physical presence in the LIDC. Therefore, an LIDC taxing income from market activities, which it did not previously tax, does not expand its underlying tax jurisdiction, but merely reasserts it, perhaps, to avert wanton loss of revenue that may ensue from maintaining the subsisting nexus compromise.

Given that the underlying normative entitlement of a market state to tax is well-established in the principles of international fiscal law, the spin-off issue in this section regards what business activities warrant the exercise of market jurisdiction. My view is that market jurisdiction merely encompasses taxation of market activity, i.e., sale to the user or customer. Any activity that is not of this nature seems extraneous to the idea of market jurisdiction and may, instead be conceptualized in some other way that justifies origin-based taxation. Yet, even if we view

market jurisdiction in this limited way, it still amounts to a broadly significant embodiment of tax jurisdiction, which, if fully exercised may substantially inundate cross-border digital trade, hence the inevitable appeal of some level of restraint.

3.4.2 How Does the Pillar One Compromise Impair Source Tax Jurisdiction?

As broadly discussed in chapter 2, a sovereign state is entitled to limit its taxing rights, and many states do so for a variety of reasons, including primarily to achieve the objective of double taxation relief. If a state elects to limit the exercise of its tax jurisdiction, it may do so unilaterally or enter into a bilateral or multilateral convention for that purpose. States have continued to follow these principles even in the context of the digital economy. In recent years, even though many states have pushed to assert their taxing jurisdiction over digital trade, those that have enacted unilateral digital tax measures have at the same time unilaterally limited the exercise of their taxing rights by stipulating taxability thresholds that exclude below threshold incomes from taxation. For instance, a country that enacts a "significant economic presence" tax legislation might aim to tax not just income from any sort of economic presence of non-residents in its territory, but only economic presence that it deems to be of "significant" quantum.[550] India's Finance Act of 2018, for instance, introduced taxation of income derived by non-resident entities through digitalized business operations in India.[551] India's SEP regime covers activities that include data or software downloads, user interaction, advertisements, and data sales.[552] However, India also introduced nexus thresholds that limit application of the tax to only non-resident persons deriving revenue in excess of INR20 million (approximately $280,000 U.S. dollars) or

[550] The example of Nigeria's SEP legislation is discussed below.
[551] See Karanjot Singh Khurana & S Vasudevan, "Significant economic presence in Indian tax law: How significant will it be?", *International Tax Review* (29 June 2021) online: https://perma.cc/38R3-UKEK.
[552] Ernst & Young, "India issues thresholds for triggering "significant economic presence" in India" (10 May 2021) online: https://perma.cc/L4ZK-WM2Y.

having a user base of over 300,000 (Indian users) in a given financial year.[553] These thresholds are meant to be active from April 2022.[554]

Countries that enact digital services tax (DST) legislation also include thresholds that limit the exercise of their taxing rights. For instance, France's proposed DST legislation would only tax (at 3%) the profits of companies generating more than €750 million in global digital sales and more than €25 million digital sales in France.[555] The estimation is that only 30 companies would fall within that scope.[556]

Likewise, Spain's proposed DST legislation that was adopted on 7 October 2020 applies a 3% tax on specified digital services revenues derived from online advertising, intermediary services and data transmission services.[557] The DST applies only to companies with worldwide revenues higher than €750 million in the preceding calendar year and the total amount of their revenue derived from the provision of digital services subject to tax exceeds €3 million in that year.[558] Spain's DST also lists various exempted activities. The exempted activities include:

> The sale of goods or services contracted online, through the website of the provider of those goods or services, in which the provider is not acting as an intermediary;" i.e., "the retail activities of 'electronic commerce'"; "The facilitation of underlying supply of goods or services directly between users, within the framework of an online intermediary service;" "The provision of online intermediary services, when the sole or main purpose of said services provided by the entity that makes a digital interface available is to provide digital content to users or provide communication or payment services;" "The provision of financial services regulated by regulated financial entities;" "The provision of data transmission services, when they are carried out by regulated financial entities;" "The

[553] *Ibid.*
[554] *Ibid.*
[555] Terry Sprackland & Stephanie Soong Johnston, "French Senate Passes DST Despite U.S. Tariff Threats," *Tax Notes* (12 July 2019) online: https://perma.cc/2NEL-WHKR.
[556] *Ibid.*
[557] USTR, *Section 301 Investigation Report on Spain's Digital Services Tax* (Washington DC: USTR, 2021) [USTR Report on Spain].
[558] *Ibid* at 6.

> provision of digital services when they are carried out between entities that are part of a group with a, direct or indirect, 100 percent ownership.[559]

The unilateral measures discussed above all contain self-imposed limits of taxing rights. The thresholds and exemptions define the extent to which each state is willing to exercise its taxing rights and the activities that the state is willing to exempt from taxation. However, the unilateral measures were mainly viewed as interim measures, to operate pending a multilateral solution,[560] and because states have such divergent ideas about what is the ideal limitation of source tax jurisdiction that they are willing to entertain, Pillar One steps in as a compromise framework that is designed to perform that tax jurisdiction restriction function on a multilateral basis. This multilateralism bears the advantage of coherence and certainty.

As earlier stated, nearly 140 countries have accepted the taxing rights limitations introduced by the Pillar One deal. What exactly are these limitations (impairments)?

There are few impairments worth mentioning here. They are mostly found in the scoping and nexus prescriptions. First, Amount A is designed to apply to only MNEs with a global turnover that exceeds €20 billion. Second, even for MNEs that meet the above €20 billion turnover threshold, they cannot be taxed (under Pillar One) unless their profitability exceeds 10% of turnover.[561] Third, Amount A only reallocates residual profits, as against the total profits earned by an MNE. Only a country where an MNE achieves a minimum turnover of €1 million can participate in the residual profits of that MNE. Of course, for "smaller jurisdictions" – countries with GDP lower than €40 billion – the participation threshold is lowered to €250,000.[562] One

[559] *Ibid* at 5.
[560] OECD, "The Tax Challenges Arising from Digitalisation: Interim Report 2018" (Paris: OECD Publishing, 2018) at 4.
[561] OECD Two-Pillar Solution *supra* note 445.
[562] *Ibid.*

can see important differences between the limits specified in Pillar One and the limits that some countries have been willing to impose on their unilateral measures. For instance, the €20 billion global turnover limit contrasts with the €750 million global turnover limit unilaterally proposed or enacted by some OECD countries. The in-country revenue thresholds of €1 million and €250,000 respectively also preclude a country from participating in an MNE's residual profit unless the threshold is met in that country. The profitability threshold of 10% also means that even a country where an MNE has attained significant sales cannot exercise its right to tax if the MNE's overall profits do not exceed 10% of turnover. In other words, there is no "residual profit" to tax. At a glance, these are restrictions that impair market state taxation.

3.4.3 A Three-Sided Reasonableness Analysis of the Pillar One Compromise

In this section I undertake a three-sided evaluation of the reasonableness of the Pillar One compromise. The reasonableness test has various components. I consider that three of these components – disparity of means, alternativity, and scope for non-tax benefits – are most fitting for conducting a reasonableness assessment of Pillar One. The first test enables an assessment of whether the compromise embodies sufficient consideration of the relative affluence of participating countries and, therefore, their capacity to give up taxing rights. The second test enables me to gauge the fairness of Pillar One against an alternative compromise that was also recently developed by the OECD's "rival" in tax policy formation, the UN. The third test enables me to explore the potential non-tax benefits of the compromise and to ascertain whether they justify or compensate for the "revenue sacrifice" that the compromise entails.

3.4.3.1 Disparity of Means

One way to gauge the fairness of the OECD Pillar One compromise is to examine the extent to which it impairs the taxing rights of countries that one may consider less able to concede taxing

rights. Pillar One makes a conspicuous concession to a certain category of LIDCs – "smaller jurisdictions" – in respect of the level of nexus that might entitle such states to partake in the exercise of market jurisdiction. The sum of €250,000 – the nexus threshold for "smaller jurisdictions" – is only a quarter of the €1 million turnover threshold that is required for all other countries. It seems evident, therefore, that a "disparity of means" consideration is embedded in the architecture of the compromise. States with less means – measured in terms of GDP – suffer a relatively small level of taxing rights impairment.

Pillar One defines "smaller jurisdictions" as countries with GDP lower than €40 billion. In US dollar terms, the €40 billion amounts to roughly $45 billion.[563] Since the deal was reached in 2021, it can be assumed that the available GDP data at the time were from 2020. It seems sensible, therefore, to examine the improvised $45 billion GDP benchmark against the backdrop of countries' 2020 GDP records. The aggregate global GDP estimate for 2020 is approximately US$85 trillion.[564] A few developed market economies like the U.S., China, Japan, The U.K., Germany, Canada, and France, as well as the likes of India, Russia, and Brazil account for a large chunk of that amount.[565] These countries' GDPs are each well in excess of "$45 billion", which means that they all come within the €1 million turnover threshold.

On the other side, many LIDCs fall within the smaller jurisdiction classification and may, therefore, take advantage of the disparity of means stipulation.[566] However, there are a good number of LIDCs that fall into the general category. These countries, despite their relatively "high" GDP are small market jurisdictions, which means that they are unlikely to retain

[563] See https://www.wsj.com/market-data/quotes/fx/EURUSD.
[564] See: https://data.worldbank.org/indicator/NY.GDP.MKTP.CD; https://statisticstimes.com/economy/projected-world-gdp-ranking.php.
[565] *Ibid.*
[566] Examples are Afghanistan, Benin, Bolivia, Burkina Faso, Cameroon, DR Congo, El Salvador, Haiti, Honduras, Jordan, Kosovo, Lebanon, Liberia, Libya, Nepal, Nicaragua, Niger, Somalia, and South Sudan, and Zimbabwe.

significant taxing rights under the general category – examples are Nigeria and Kenya, two of Africa's most populous countries.[567] Nigeria's 2020 GDP was roughly $429 billion while Kenya's was a little above $101 billion.[568] I am keen to point out Nigeria and Kenya because both countries maintain a digital tax law, which underscores their eagerness to assert their tax jurisdiction in the digital economy, and also because both countries are "dissenters" to the Two-Pillar agreement (including Pillar One). These two dynamics are discussed below.

Nigeria introduced a digital tax into its domestic law through the Finance Act 2019, which was subsequently complemented by the Finance Act 2021.[569] The two statutes amend subsection 13(2) of the Companies Income Tax Act (CITA), a statutory provision that governs the taxation of business profits earned by non-resident companies in Nigeria.[570] Nigeria's digital tax legislation is based on the SEP model. The amended paragraph 13(2)(c) of CITA stipulates that the profits of a non-resident company from any trade or business shall be deemed to derive from or be taxable in Nigeria where that company:

> [t]ransmits, emits or receives signals, sounds, messages, images or data of any kind by cable, radio, electromagnetic systems or any other electronic or wireless apparatus to Nigeria in respect of any activity, including electronic commerce, application store, high frequency trading, electronic data storage, online adverts, participative network platform, online payments and so on, to the extent that the company has significant economic presence in Nigeria and profit can be attributable to such activity.

A non-resident company is, therefore, liable to tax in Nigeria if it carries out business in Nigeria through a designated electronic means, in so far as the company meets the required SEP threshold in Nigeria and profit can be attributed to its Nigerian activities.

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[567] "Country Comparison Nigeria vs Kenya" online: https://perma.cc/67V5-ACKH.
[568] World Bank, "GDP (current US$)", online: https://data.worldbank.org/indicator/NY.GDP.MKTP.CD.
[569] Finance Act 2019, section 4(a)(ii); Finance Act 2021, section 4.
[570] Companies Income Tax Act 1961, No. 22, Cap C21 LFN 2004, as amended

The SEP threshold is not stipulated in the CITA. A ministerial order fulfills that purpose. Pursuant to the Companies Income Tax (Significant Economic Presence) Order 2020 (SEP Order) a non-resident company is deemed to have an SEP in Nigeria in any one of three ways: (1) if its digital trade activities earn a turnover or income amounting to more than ₦25,000,000 (U.S.$60,000) in the relevant accounting year from an in-scope activity; (2) if it uses a Nigerian domain name or registers a website address in Nigeria; or (3) if it has "a purposeful and sustained interaction with persons in Nigeria by customising its digital page or platform to target persons in Nigeria…".[571]

With respect to enforcement, a newly added paragraph 30(b)(iia) of the CITA empowers the tax authority to assess and charge an in-scope company (for a given year of assessment) "on such fair and reasonable percentage of that part of the turnover attributable to that presence" where the true amounts of the company's assessable profits cannot be ascertained. This provision grants the tax authority discretion in applying a tax rate that it deems reasonable in the taxation of income derived by a non-resident company. Nigeria's Finance Minister has, during a budget speech to the National Assembly, implied that the digital tax regime could result in a 6% turnover tax assessment for non-resident companies.[572]

With Nigeria being an active member of the OECD Inclusive Framework throughout the development of its digital tax legislation, the unilateral measures were designed to operate pending its substitution by a multilateral compromise agreed at the OECD.[573]

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[571] Companies Income Tax (Significant Economic Presence) Order 2020, subsection 1(1).
[572] Chijioke Ohuocha, "Nigeria plans to tax digital non-resident firms at 6% of turnover", *Economic Times* (6 January 2022) online: https://perma.cc/F4SD-MGJH; . Amarachi Orjiude, "Nigerians to pay VAT for digital services – Finance minister", *Punch NG* (5 January 2022) online: https://perma.cc/HCW8-B7FT.
[573] SEP Order*,* subsection 1(3).

Like Nigeria, Kenya introduced digital taxation in 2019. Kenya amended its Income Tax Act to include a provision that taxes income generated through a "digital marketplace".[574] Section 3 of the Finance Act 2019, which amends section 3 of the Income Tax Act, defines "digital marketplace" as "a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means."[575] The Finance Act mandates the Cabinet Secretary for national treasury and planning to make regulations to provide for the implementation of the new tax regime.[576] In June 2020, Kenya enacted the Finance Act 2020 to introduce further amendments to the Income Tax Act, including what the Act terms a "digital service tax". Section 4 of the Finance Act provides that:

> (1) Notwithstanding any other provision of this Act, a tax to be known as digital service tax shall be payable by a person whose income from the provision of services is derived from or accrues in Kenya through a digital market place:
>
> Provided that a resident person or a non-resident person with a permanent establishment in Kenya shall offset the digital service tax paid against the tax payable for that year of income.
>
> (2) The tax payable under subsection (1) shall be due at the time of the transfer of the payment for the service to the service provider.

The tax rate for Kenya's digital service tax is 1.5% of the gross transaction value.[577] Unlike what obtains in some jurisdictions, including Nigeria, Kenya's DST regime does not include a turnover nexus threshold. DST paid by a resident or non-resident person with a permanent establishment in the country may be offset against the person's tax liability for the applicable

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[574] Finance Act No. 23 of 2019, section 3.
[575] *Ibid,* paragraph 31.
[576] *Ibid,* para 3(b).
[577] Finance Act No. 8 of 2020, section 9.

year of assessment. However, DST paid by a non-resident person without a permanent establishment in Kenya is the final tax for that person.[578]

In December 2020, Kenya's designated cabinet secretary issued a subsidiary legislation, the Income Tax (Digital Service Tax) Regulations, 2020. The regulations connect the two preceding statutory amendments by defining "digital service" as "any service that is delivered or provided over a digital marketplace."[579] The regulations also flesh out Kenya's DST regime by identifying a broad collection of activities that come within the scope of taxable digital services. The in-scope activities include:

> (a) downloadable digital content including downloadable mobile applications, e-books and films; (b) over-the-top services including streaming television shows, films, music, podcasts and any form of digital content; (c) sale of, licensing of, or any other form of monetising data collected about Kenyan users which has been generated from the users' activities on a digital marketplace; (d) provision of a digital marketplace; (e) subscription-based media including news, magazines and journals; (f) electronic data management including website hosting, online data warehousing, file-sharing and cloud storage services; (g) electronic booking or electronic ticketing services including the online sale of tickets; (h) provision of search engine and automated held desk services including supply of customised search engine services; (i) online distance training through pre-recorded media or e-learning including online courses and training; and (j) any other service provided through a digital marketplace.[580]

The law applies to every person (platform) that provides or facilitates the provision of a digital service to a Kenya-based user.[581] This includes a website and mobile application and covers any business activities carried out over the internet or any electronic network, including traditional electronic markets like eBay and social media like Facebook.[582] The regulations are designed to

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[578] Income Tax (Digital Service Tax) Regulations, 2020, subsection 4(3).
[579] *Ibid*, section 2.
[580] *Ibid,* subsection 3(1).
[581] *Ibid,* subsection 5(1).
[582] Mercy Muendo, "Kenya is Moving Aggressively to Tax Digital Business. What Next?", *The Conversation* (22 August 2021) online: https://perma.cc/EG36-T737.

tax both residents and non-residents who accrue income from a digital marketplace.[583] They, however, exclude application of the DST to financial institutions specified in the fourth schedule of the Income Tax Act, financial service providers authorized or approved by the Central Bank of Kenya, and online services provided by government institutions.[584]

Kenya is a relatively small market jurisdiction whose digital services market revenue is projected to reach US$4.4 billion in 2022, up from $1.4 billion in 2016.[585] However, while there is no public disclosure yet of how much revenue Kenya is deriving from its DST law, the country reportedly has 89 companies already paying the DST.[586] This number includes companies like Uber and Booking.com.[587] Kenya claims that because of the "high" scope and nexus thresholds contained in Pillar One, replacing its current DST law with Pillar One framework will see the number of in-scope companies drop from 89 to 11.[588] This is because only 11 of the companies that are in-scope of Pillar One operate in Kenya and, of that number, it is not quite clear how many meet the threshold for in-country turnover that would preserve Kenya's right to tax.[589] Given these circumstances, it may not be surprising that Kenya has been unwilling to commit to the deal.[590] When we look at these numbers and circumstances, we have to ask whether this is a level of impairment of tax jurisdiction that is reasonable for a small market jurisdiction like Kenya to accept?

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583 *Ibid.*
584 Income Tax (Digital Service Tax) Regulations, *supra* note 578 subsection 3(3).
585 Kimberly Miltz, "Business Digital Services Revenue in Kenya 2016-2022, by Service Type", *Statista* (20 September 2021) online: https://perma.cc/K4S4-RCSG.
586 Mureithi *supra* note 502.
587 *Ibid.*
588 *Ibid.*
589 *Ibid.* Neither Uber nor Booking.com (Booking Holdings) would fall within the scope of Pillar One, based on their 2020 global revenue. See: Erick Burgueño Salas, "Uber's Revenue Segment 2017-2020", *Statista* (20 October 2021) online: https://perma.cc/N97X-8EMB; Statista, "Revenue Booking Holdings 2007-2020" (25 February 2021) online: https://perma.cc/8ZSH-RK5R.
590 Orria Goni & Luckystar Miyandazi, "The Global Corporate Tax Deal – An African Perspective", *UNDP blog* (5 January 2022) online: https://www.undp.org/blog/global-corporate-tax-deal-african-perspective.

It is important to stress that an evaluation of reasonableness is a country-by-country affair. What is reasonable for one country may not be reasonable for another country. Thus, not all "LIDCs" are situationally identical. The facts and circumstances highlighted above demonstrate why the Pillar One compromise might fail the reasonableness test for Kenya despite the disparity of means content of the compromise.

There are genuine concerns that the compromise imposes significant impairments on the tax jurisdiction of countries like Kenya and Nigeria due to the narrow scope of the deal which excludes many companies that operate in these countries.[591] While Pillar One's revenue and profitability scoping thresholds currently in play might seem reasonable for large market jurisdictions, its revenue implications for small market jurisdictions like Kenya and Nigeria might be hard to swallow. Perhaps one way to address the problem, within the Inclusive Framework, is to allow for variable scoping thresholds, based on groups of countries or for LIDCs to implement flexible scoping (and nexus) rules based on the company's level of involvement in a country's economic life.[592]

The nexus thresholds may also significantly undermine the taxing rights of some LIDCs because they are not large market jurisdictions where the biggest (in-scope) MNEs are likely to meet the specified nexus threshold.[593] Needless to state that countries like Kenya and Nigeria are also excluded from the scope of the €250,000 nexus threshold since their respective GDPs exceed the

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[591] See WATAF, "WATAF Commentary on the OECD/G20Inclusive Framework Two-Pillar Solution to Address the Tax Challenges" (8 October 2021) online: https://perma.cc/AK9Y-JANW ["The scope threshold has left out key MNEs exploiting the markets of our members from the scope of Pillar 1, while most of the in-scope MNEs have no significant engagement with our markets."]

[592] See Hearson *supra* note 444.

[593] Going by recent World Bank statistics, the world's big consumer markets remain the OECD countries and emerging markets such as India, Brazil, and China. With a high taxability threshold, it is unlikely that most LIDCs will fall into the category of market jurisdictions that can tax digital trade. See World Bank, "Final Consumption Expenditure (current US$)" (2020) online: https://data.worldbank.org/indicator/NE.CON.TOTL.CD.

€40 billion threshold that qualifies a country as a "smaller jurisdiction". The rationale for the minimum threshold (*de minimis* threshold) is to ensure that companies only become taxable if they have sufficient involvement in a country's economic life.[594] That, in itself, might not be unreasonable. However, the real concern is that a threshold as high as €1 million also has the potential to greatly undermine the tax base of states like Kenya and Nigeria since the "high" thresholds – as well as the scoping rules – effectively exclude most of the companies that operate digitally in these countries.[595] The prospect of revenue loss deters some developing countries (with relatively small markets) – who, because of GDP, fall outside the "small jurisdiction" classification – from signing up to the deal.

Nigeria, for example, has made clear that it welcomes Pillar Two, but cannot sign up because of its opposition to Pillar One's terms.[596] Nigeria's lead negotiator at the Inclusive Framework, Mathew Gbonjubola, claims that the country's concerns about the potential revenue impact of the Pillar One (nexus) rule design for developing countries were not addressed:

> The economic impact assessment that was carried out on Pillar 1 and 2 were founded on an unreliable premise. The country-specific impact assessment that was done was top-down. Somebody just looked at the GDP of Nigeria, and says Nigeria's GDP is this much and then they should be able to buy this number of shoes and things like that. And you and I know, in that kind of postulation, the margin of error is usually very wide. That exactly was what happened with this. Particularly for Nigeria, when we ran the numbers it was way off the figures that the OECD gave us.[597]

This assessment advances the view that GDP (without consideration for market power) might be an inadequate metric for determining the appropriate threshold for a market-based apportionment

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[594] See Hearson *supra* note 444.
[595] Ndajiwo & Nyamudzanga *supra* note 470.
[596] Johannes Oluwatobi, "Nigeria is not in Hurry to Sign OECD Corporate Tax Agreement – FIRS", *PR Nigeria* (30 November 2021) online: https://prnigeria.com/2021/11/30/nigeria-hurry-sign-oecd/. On U.S. prompting, Pillar One and Pillar Two were co-joined so that a country could not sign one without the other.
[597] *Ibid.*

of taxing rights. Countries like Nigeria, with GDP above U.S.$45 billion, risk losing taxing rights because their relatively high GDP does not align with their status as relatively small market states.[598] Such outcomes can reinforce the distributional bias that already exists in the proposed framework.[599] The West African Tax Administration Forum (WATAF) has thrown its support to the arguments against the current nexus rules, with respect to Nigeria and other West African states in the Inclusive Framework:

> The building block on nexus, which sets an in-country revenue threshold that will qualify a jurisdiction for a share in Amount A profit at EUR 1 million (and EUR 250 000 for smaller jurisdictions with GDP lower than 40 billion) is too high for our members, as it has further reduced the number of MNEs from which they may get Amount tax revenue. With the existing nexus rule, none of our members is getting Amount A share of profits from up to 10 MNEs in the near future, while some have even complained that they may not get Amount A share of profit from any MNE.[600]

It is difficult to dismiss the contention that the inclusion of a nexus threshold, while generally defensible on administrability grounds, might also unreasonably impair the taxing rights of some LIDCs. A less restrictive and more nuanced approach would tailor its scoping and nexus rules to account for market size rather than just GDP. This would ensure that smaller market states, including like Kenya and Nigeria, retain the right to tax income from digital business activities in their domain. Such an approach would better reflect the disparity of means between parties to the Pillar One compromise and would inflict a more reasonably impair their tax jurisdiction than the current framework.

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[598] Christians & Magalhães *supra* note 43 at 1175–1176. These scholars were analyzing the nexus rules contained in an earlier proposed version of the Pillar one tax deal, the "Unified Approach". The eventual deal retains the same kinds, if not harsher, forms of distributional principles that the scholars attacked in the earlier version. For a similar view, see Cobham, Faccio & FitzGerald, *supra* note 41 arguing that lower-middle income countries would lose tax base, in aggregate under approaches – such as the Unified Approach – that rely on sales only to allocate taxing rights. In contrast, high-income countries will benefit the most from such an approach.

[599] Christians & Magalhaes *ibid.*

[600] WATAF *supra* note 591.

3.4.3.2 Alternativity: Article 12B of the UNMTC

The alternativity test developed in chapter 2 can also be used to analyze the OECD Pillar One compromise. There are several alternatives that have been considered or implemented in recent years by countries and institutions. A few of these alternatives are discussed in previous sections of this work. I observe that many of these alternatives are in the form of DSTs, turnover taxes imposed by source countries on digitalized transactions. Bearing that element of similarity in mind, I elect to analyze one of the alternatives, the legal framework for taxation of automated digital services introduced by the UN Tax Committee into the UNMTC in 2021. Comparing this alternative seems sensible because of the UN Tax Committee's historical role in advancing international tax policies that are considered more sensitive to the needs of LIDCs and the fact that Article 12B was specifically designed with the interest of LIDCs in mind.[601]

3.4.3.2.1 Basic Details

The UN Tax Committee's active involvement in modernizing the international tax regime as a response to the tax challenges arising from the digitalization of the economy reached concrete levels in 2017 when the committee inserted a new Article 12A in the UNMTC. Article 12A permits the source state to tax (on a gross basis) "fees for technical services" provided by non-residents without a permanent establishment or fixed base in the state of the payer.[602] This Article was added at a time of notable protraction in the OECD's efforts to craft a consensus solution for the broader problems of taxation in the digital economy. The UN Tax Committee underlined its willingness to

[601] It is also worth mentioning that the UN Tax Committee consulted the work of the OECD, the EU, and the African Tax Administration Forum when putting together its own proposal. See Randy Buchanan, Robert Chase II & Mary Kate Nicholson, "First to Finish: UN Approves Article 12B for Taxation of Automated Digital Services", *Eversheds Sutherland (US) LLP* (4 May 2021) online: https://perma.cc/GE2D-YVLS.
[602] UNMTC, Article 12A.

forge ahead of the OECD in designing a solution that countries could adopt for the purpose.[603] A major development in this regard was recorded on 5 August 2020, when the committee published an amended draft proposal for taxation of "automated digital services".[604] The proposal was designed to enable source countries to tax cross-border payments for "automated digital services" either through a withholding tax on gross income or a net income apportionment formula.[605] However, non-resident entities providing "automated digital services" can decide which approach they prefer. They may opt for a withholding tax on gross income, at a pre-stipulated tax rate, or they may opt for a net income tax on a company's "qualified profits", at a rate determined by the source country's domestic law. A final draft of the proposed Article 12B, as well as amendments to the commentary, was adopted at the committee's 22nd Session, in April 2021[606], and has since been incorporated into the UNMTC.[607]

3.4.3.2.2 Scope

Article 12B permits a source state to tax the income of a non-resident person arising from "automated digital services".[608] Paragraph 12B(5) defines "automated digital services" (hereafter ADS) as "any service provided on the Internet or another electronic network, in either case requiring minimal human involvement from the service provider." The definition is complemented by Paragraph 12B(6) which outlines the services that qualify as ADS, namely: online advertising, supply of user data, online search engines, online intermediation platforms, social media platforms,

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[603] See UN Tax Committee, *Fifteenth session, Tax consequences of the digitalized economy – issues of relevance for developing countries*, E/2018/45-E/C.18/2018/1 at 34.
[604] UN Tax Committee, *New Article 12B on Taxation of 'Income from Automated Digital Services* (New York: UN, 2020).
[605] Nana A Sarfo, "Why the United Nations Digital Tax Proposal Deserves More Attention" (2020) Tax Notes Intl 995.
[606] UN Tax Committee, *Report on Twenty-second Session, Tax Consequences of the Digitalized Economy – Issues of Relevance for Developing Countries*, E/C.18/2021/CRP .1.
[607] UNMTC.
[608] *Ibid*.

digital content services, online gaming, cloud computing, and standardized online teaching services. The use of "includes" in relation to the listed items suggests that the list is inexhaustive. However, Article 12B also stipulates that there are certain remote activities that are outside its scope of application. Thus, any payment that would qualify as "royalties", pursuant to Article 12, or "fees for technical services", pursuant to Article 12A does not qualify as payment for ADS.[609] Also, Article 12B does not cover taxation of CFBs.[610]

Further, where payment for ADS accrues to a person (as beneficial owner) who is a resident of one of the treaty states from activities carried out by that person in the other state, either through a permanent establishment or fixed base, the payment is not covered by Article 12B but instead falls under either Article 7 or 14.[611] This provision maintains the general priority of the permanent establishment rule, since the ADS rule is designed to deal with situations where income is remotely derived (i.e., without the using a permanent establishment or fixed base).

3.4.3.2.3 Nexus

Article 12B does not stipulate any threshold requirements, such as a permanent establishment, fixed base, minimum period of presence or minimum sales amount before which the source state can tax.[612] This implies that nexus is formed once payment flows from one contracting state to another in exchange for the provision of ADS. The fact that modern digital technology allows for substantial exchange of paid cross-border ADS with little or no presence in the source state justifies the non-requirement of physical thresholds in the source state.[613] This omission, however, should

[609] UNMTC, article 12B, paragraph 12B(7).
[610] Commentary on the UNMTC, article 12B, paragraph 58 (iv).
[611] *Ibid,* paragraph 12B(8).
[612] See the Commentary on UNMTC, article 12B, paragraph 7.
[613] *Ibid.*

not be construed to mean that a state cannot maintain a threshold under its domestic legislation. It only means that the treaty does not "impose" or expressly recommend a threshold.

3.4.3.2.4 Revenue Sourcing

There are two independent sourcing rules for Article 12B. The first is that the person paying for ADS resides in the taxing state (the source state). The second is that the person paying for ADS has a fixed base or permanent establishment in the taxing state "in connection with which the obligation to make the payments was incurred, and such payments are borne by the permanent establishment or fixed base".[614] In either case, the state from where the payment is made is deemed the source state. However, Paragraph 12B(10) emphasizes that if payments for ADS are made by a resident of, say, state A, which carries on business in state B through a permanent establishment situated in state B (or performs independent personal services through a fixed base situated in state B) and such payments are borne by that permanent establishment or fixed base then the income from ADS shall be deemed not to arise in state A. Instead, it shall be deemed to arise from state B where the permanent establishment or fixed base is located.

3.4.3.2.5 Profit Allocation

Article 12B allocates rights to tax business profits to the market jurisdiction, a marked departure from the current rules of international tax which allocate taxing rights to jurisdictions where supply side activities take place. There are two approaches to profit allocation in Article 12B. There is a gross profits option (paragraph 2), which is the default approach, and a net profits option (paragraph 3), which supersedes the former whenever it is invoked (by the taxpayer). Both approaches emphasize that it is the income of the beneficial owner that is taxable, which means

[614] UNMTC, article 12B, paragraph 12B(9).

that the treaty would only apply if the beneficial owner is a resident of either state; and, therefore, nullifies the potential for tax avoidance through intermediary entities.

(a) Taxation of Gross Income

Pursuant to paragraph 2, a source state may tax payments for ADS on a gross basis in accordance with its own domestic law. The applicable tax rate is left to bilateral negotiation by the contracting states. However, the commentary of Article 12B recommends a "modest" rate of 3 or 4 percent.[615] This "modest" rate recommendation is explained by the perception that a gross basis taxation may result in "double or excessive taxation".[616] While a modest rate may not eliminate double or excessive taxation, it, at least, limits the exposure.

For administrative convenience – i.e., owing to the presumed physical absence of the beneficial owner of income from the source state – Article 12B envisages that this gross basis tax would be enforced as a withholding tax.[617] The withholding tax option places the administrative capacity of LIDCs at the center of consideration. Paragraph 5 of the commentary of Article 12B explains that:

> Many developing countries have limited administrative capacity and need a simple, reliable and efficient method to enforce tax imposed on income from automated digital services derived by non-residents. A withholding tax imposed on the gross amount of payments made by residents of a country, or non-residents with a permanent establishment or fixed base in the country, is well established as an effective method of collecting tax imposed on non-residents.[618]

From a taxpayer' perspective, the commentary explains that "a method of taxation may also simplify compliance for enterprises providing such services in another State, since they would not

[615] *Ibid,* paragraph 4.
[616] *Ibid.*
[617] Commentary of UNMTC, article 12B, paragraph 5.
[618] *Ibid.*

be required to compute their net profits or file tax returns, unless they opt for net income basis taxation".[619]

(b) Taxation of Net Income

The gross profit tax regime set out in paragraph 12B(2) may be substituted for an annual net profits tax, at the instance of the non-resident taxpayer. Paragraph 3 contains elaborate provisions on net basis taxation. It entitles the taxpayer to request the source state to tax its "qualified profits" (rather than gross profits) at the rate specified in the domestic law of that state. Once a request is made, the source state is obligated to comply.

Paragraph 3 stipulates that "qualified profits" shall be 30% of the amount resulting from applying the profitability ratio of the beneficial owner's ADS business segment, where available, to the gross annual revenue from ADS derived from the source state. However, where the beneficial owner does not maintain segmental accounts, the overall profitability ratio of the beneficial owner will be the basis to determine qualified profits. If the beneficial owner belongs to an MNE group, the applicable profitability ratio is that of the group, or of its ADS segment, if the latter is available.[620] However, to avoid undermining the tax base of the source state, the group profitability ratio can only be the basis of computation if it is higher than the beneficial owner's profitability ratio.[621]

The qualified profits ascertainment may be broken down as follows:

a. Option A1: 30% of the amount resulting from the profitability ratio of the beneficial owner's ADS segment.

[619] *Ibid.*
[620] *Ibid,* paragraph 3.
[621] *Ibid.*

b. Option A2: If the beneficial owner does not maintain segmental accounts, 30% of the overall profitability ratio of the beneficial owner.

c. Option B1: 30% of the amount resulting from the profitability ratio of the MNE group's ADS segment.

d. Option B2: If the MNE group does not maintain segmental accounts, 30% of the overall profitability ratio of the group. This option only prevails if the profitability ratio of the group is higher than the profitability ratio of the beneficial owner at entity level.[622]

An advantage of net basis taxation is that it allows the beneficial owner to incur less tax liability than it might if its income were taxed on a gross basis, as well as relief where the taxpayer has a global business loss or loss in its ADS segment during the taxable year.[623] In the case of net basis taxation, the taxpayer's exposure to double or excessive taxation is further reduced or eliminated by the home state through exemption or credit under Article 23.[624]

3.4.3.2.6 Comparative Analysis

Is the Article 12B framework a more reasonable alternative to the Pillar One compromise from the perspective of LIDCs? There are two factors that I consider in my response to this question. First, I compare, based on the metrics of scope, nexus, and profit allocation, the extent to which both compromises might impair the tax jurisdiction of LIDCs. Assuming that Article 12B is the less restrictive option, I also consider whether Article 12B – if adopted – sufficiently addresses the distortive problem of double taxation, vis-à-vis Pillar One. I make this extra consideration because

[622] The aim is to neutralize "the possible reduction of the profitability due to tax-driven related party transactions in the MNE group". Commentary of Article 12B, paragraph 42. Presumably, the same purpose drives Article 12B's denial net basis assessment to an entity where the profitability ratio of the MNE group to which it belongs is not available to the source state. In that case the default gross basis taxation is applicable. The improvised option A2 is merely a backstop to option A1. Likewise, option B2 operates as a backstop to option 2A.

[623] Commentary of Article 12B, paragraph 39.

[624] Commentary of Article 12B, paragraph 4. See also UNMTC, Article 23.

I do not think that it is sufficient that an alternative compromise is more deferential to the tax jurisdiction of LIDCs. An ideal compromise should preserve the tax base of LIDCs but, at the same time, should strive to not place excessive and distortive tax barriers on international trade.

(a) Scope

There are overt differences between the scope of Pillar One and Article 12B. Pillar One allows the taxation of MNEs with a global turnover of €20 billion and profitability above 10%. This applies to MNEs from all sectors of the global economy, except MNEs in the extractive sectors and MNEs providing regulated financial services. Article 12B, on the other hand, applies to any non-resident entity that derives income from ADS. The designated carveouts from Article 12B are payments that are classified as royalties and fees for technical services, as well as payments for CFBs.

Pillar One has a broader industry coverage than Article 12B. This is because its application is not limited to so-called digital business models or "highly digitalized businesses". Article 12B, on the other hand, is narrower because it only applies to an entity that provides ADS. This means that it has a more streamlined focus on "highly digitalized businesses". Given that limitation, one edge that Pillar One's broader scope has over the Article 12B scope is the former's implicit inclusion of so-called Consumer Facing Businesses (CFBs). The OECD defines CFBs as "those businesses that generate revenue from the sale of goods and services of a type commonly sold to consumers, including those selling indirectly through intermediaries and by way of franchising and licensing"[625] Article 12B, in its definition of "online intermediation platform services",

[625] OECD Pillar One Blueprint *supra* note 443 at 21, paragraph 33.

reveals that "the online sale of goods and services of the platform's own inventory", which is a form of CFB, is outside the scope of the framework.[626]

The exclusion of CFBs from the scope of Article 12B may be especially problematic. At an earlier stage of development, the OECD grappled with the issue of whether Pillar One should apply mainly to digitalized business models, i.e., to business providing ADS, as well as to CFBs.[627] ADS focuses on a narrower group of digital business models, i.e., "highly digitalized businesses", while CFB merely reflects the sale of goods and services that are commonly sold to consumers, albeit in a manner that is facilitated by digitalization.[628] A focus on ADS ringfences the digital economy and defies the reality that in the era of globalization and digitalization, all businesses can – local physical presence notwithstanding – participate in the economic life of a market jurisdiction in an active and sustained manner.[629] The question of what business models would fall into either category and the potential non-neutrality and unfairness of excluding CFBs were niggling issues and, apparently, contributed to the stalling of a political agreement on Pillar One.[630] At some point, some members of the Inclusive Framework advocated

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[626] Commentary on the UNMTC, article 12B, paragraph 58 (iv).

[627] OECD Pillar One Blueprint *supra* note 443.

[628] *Ibid* at 21, paragraph 33.

[629] Ayush Tripathi & Shefali Mehta, "Taxation of Digitalized Economy: Analysing the United Nations Article 12B", *ELP Associates & Solicitors* (2021) online: https://perma.cc/AS4J-R42S at 10. The authors rightly argue that global tax rules should be designed in a way that does not limit their fitness for application in the evolving future, in line with the principles of neutrality, certainty, flexibility, and simplicity.

[630] The proposed definition of ADS includes a "positive list" of items such as online advertising, sale or alienation of user data, online search engines, social media platforms, online intermediation platforms, online gaming, digital content services, and cloud computing. OECD Pillar One Blueprint *supra* note 443 at 24–25. There is no such list of businesses that constitute CFB. The OECD merely describes CFBs and notes that "A good or service is "of a type commonly" sold to consumers if the nature of the good or service is such that it is designed primarily for sale to consumers. This presupposes that the good or service is made available in ways capable of being for personal consumption (such as in portions, in sufficiently finished or usable form, or at purchase points accessible by an individual, as opposed to bulk or raw material accessible to wholesale traders or other businesses only). To be designed primarily for sale to consumers means that the MNE developed the goods or services to be regularly, repeatedly, or ordinarily supplied to consumers (whether directly or indirectly), such as by engaging in consumer market research, marketing and promoting it to consumers, using consumer / user data, or providing consumer feedback or support services (irrespective of the location in which such activities take place)". A given example is pharmaceutical products (drugs) that are developed with the help of consumer data and sold directly to consumers or through medical

a phased implementation, starting with ADS and subsequently including CFB.[631] These scoping challenges were eventually resolved with the intervention of the new U.S. government in mid-2021, which proposed the removal of these uncertain and potentially "discriminatory" classifications, in favor of a simpler scoping design that targets all MNEs regardless of sector.[632] As I discuss in section 3.5, that U.S. intervention was key to the consensus on Pillar One.

The exclusion of CFBs from Article 12B limits the scope of businesses that LIDCs, as market states, can tax, as well as leaves the hanging question of discrimination. From an administrative perspective, Pillar One is also considered preferable because it significantly limits controversy as to whether a particular business model falls within the scope of the regime.

The other major scoping difference between Pillar One and Article 12B is in the revenue threshold of Pillar One. As earlier stated, Article 12B does not contain a revenue threshold for the purpose of determining the entities that fall within its scope. This means that a state utilizing Article 12B can tax the income of any non-resident entity derived from ADS provided to a payor in that state. Pillar One toes a different path. A combination of the €20 billion global turnover threshold and the above 10% profitability ratio significantly diminishes the number of entities that may be subject to tax. As mentioned in section 3.4.3.1, less than 100 of the most profitable

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professionals and insurers. The common reliance on consumer data, in particular, may raise questions about whether digitalized businesses should be taxed differently (as ADS) from pharmaceutical companies (CFBs). See Grinberg *supra* note 541.

[631] OECD Pillar One Blueprint *supra* note 443 at 12.

[632] The carveouts for extractives and financial services countries were introduced during negotiations, following the U.S. intervention. Countries came to a consensus that it made sense to keep the subsisting tax rules for extractives, which is that the country where the extractives are located has the preeminent right to tax. See OECD MTC, Article 6 and UNMTC, Article 6. The carveout for regulated financial services was mainly pushed by the UK to shield the City of London banks (Britain's huge financial hub) from more taxes arising from their overseas operations. See Paul Withers, "Rishi Sunak Secures Global Tax Win for UK as US Counterpart Backs Down in Crunch Talks", *Express* (1 July 2021) online: https://perma.cc/R6TQ-NZXN; Chris Giles & George Parker, "Financial Services Sector Set for Carve-out from New Global Tax Rules", *Financial Times* (30 June 2021) online: https://perma.cc/J6G8-GS2A ["The UK believed financial services would be carved out from the new global tax rules because regulation forces banks to be separately capitalized in every jurisdiction they operate in, so that they declare profits and pay tax in the countries in which they do business."].

MNEs fall within this scope.[633] It is notable that prior to the 2021 U.S. intervention, the Inclusive Framework was considering a global turnover threshold of €750 million.[634] The reasoning was that setting a threshold below that amount would "lead to substantial compliance burdens without commensurate benefits in terms of the available reallocation for market jurisdictions."[635]

The sensational jump from a €750 million global turnover threshold to €20 billion turnover threshold seems remarkably unattractive, especially from the perspective of LIDCs, and does not appear to be grounded in a defensible rationale of administrability. On the other hand, the global turnover threshold has the potential to greatly impair the tax jurisdiction of some LIDCs who may be forced to forgo significant revenue by not taxing non-resident entities that do not meet that fantastically high threshold even when such entities have significant market activities in the LIDC. I again refer to the example of Kenya which may see the number of in-scope entities fall drastically from 89 to 11.[636]

Scholars have outright questioned the necessity of a global turnover threshold. For instance, Harpaz argues that a global turnover threshold is entirely unnecessary and should be abandoned in favour of a country-specific threshold which better reflects the level of engagement of an MNE with the taxing country.[637] A global turnover threshold ignores the reality that a "small" global MNE may, nonetheless, have a heavy market presence in a particular state. It does not seem reasonable to deprive such a state the right to tax simply because the MNE's global turnover may not be large enough in the eyes of other (wealthier) states.

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[633] Michael Devereux & Martin Simmler, "Who Will Pay Amount A" (2021) EconPol Policy Brief 36/2021.
[634] OECD Pillar One Blueprint *supra* note 443 at 22, paragraph 37.
[635] *Ibid*.
[636] Ndajiwo & Nyamudzanga *supra* note 470; Goni & Miyandazi *supra* note 590.
[637] Assaf Harpaz, "The OECD's Unified Approach: Nexus, Scope, and Coexisting with DSTs" (2019) 96:10 Tax Notes Int'l 909 at 910.

It is arguable that the absence of a global turnover is more consistent with the idea of wealth creation since it is tailored to ensure that an MNE is taxed in the state where it derives substantial revenue. Perhaps a better approach would be to make the two forms of turnover threshold applicable in the alternative. This means having a general global turnover rule that captures only the largest MNEs, but, at the same time, a market state would retain the right to tax an MNE that is outside the global turnover scope if that MNE has a required market presence in that state. This differentia may be limited to LIDCs, in order not to render the general rule irrelevant.

Following from the above, the absence of a global threshold in Article 12B means that an MNE with less global turnover, but with significant market activities in an LIDCs, would not be excluded from the LIDC's tax base. It is not surprising that the unilateral measures that some LIDCs have initiated lean closer to the UN framework than the OECD framework. Nigeria and Kenya, two of the countries that have been reluctant to embrace the Pillar One compromise, do not stipulate a global turnover threshold in their domestic legislation. Even those OECD countries, e.g., Canada, France, and Spain, that specify a global turnover threshold, tend to pick the €750 million that was earlier considered by the Inclusive Framework.[638]

The absence of a global turnover and profitability threshold in Article 12B means that no entity providing ADS in a state is exempt from taxation on those grounds. It could also mean that the tax authority has substantially more non-resident taxpayers to assess. While this structure might pose compliance burdens for taxpayers and tax administrators,[639] I am not convinced that the solution

[638] See, e.g., Canada: Draft Digital Services Tax Act, paragraph 10(1)(a); USTR, Report on France's Digital Services Tax Prepared in the Investigation under Section 301 of the Trade Act of 1974 (Washington DC: United States Trade Representative, 2019) at 22; USTR Report on Spain *supra* note 557. See also Council of European Union, *Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services* (Brussels: EU, 2018) at 25.
[639] See Elma Hadzovic, "Taxing the Digital Economy in Developing Countries: A Legal Comparison Between OECD's Pillar One and UN's Article 12B" (LLM Thesis, Lund University, 2021) at 57.

is to insert a global turnover threshold. Rather, I am of the view that the appropriate test should be how much turnover or economic involvement the entity has in the taxing market state. To this end, I am more concerned about the restrictive impact of the €20 billion global turnover in Pillar One than the lack of a global turnover threshold in Article 12B. The former imposes unnecessary and, perhaps, distortive, impairment on the tax jurisdiction of market states where significant economic activities take place, while the latter can be solved by inserting a nexus threshold.[640]

The scope of Pillar One simply does not seem broad enough. A deal that covers fewer than the top 100 MNEs in the world means that a clear majority of entities will continue to be taxed under the old rules (permanent establishment). As previously stated, those rules tilt the allocation of taxing rights mainly in favour of HIDCs where highly digitalised MNEs reside.[641] Pillar One ensures that most of these MNEs who operate in the markets of LIDCs are exempt from source state taxation.[642] Such MNEs can exploit the markets of LIDCs without meeting the required presence to contribute to the tax revenue of LIDCs.

On scoping, I think that Article 12B is slightly better than Pillar One, for LIDCs. Both approaches impose limits on the exercise of taxing rights: Article 12B in terms of business models (qualitative limits) and Pillar One in terms of revenue thresholds (quantitative limits). Pillar One appears to be significantly more restrictive. Although Article 12B does not cover CFBs, the broad spectrum of

[640] Hadzovic rightly argues that a global revenue threshold can be a distorting factor. It may influence businesses that are close to the threshold, especially, to plan around it, to avoid taxation. It may also discriminate between two business with equal tax paying capacity. She notes, for instance, that two MNEs that have identical local sales revenue in a market state may be subject to different tax treatments because of disparities in their global revenue. Thus, "even if an MNE has ten times larger local sales than another MNE in a market jurisdiction, it can still avoid the application of Pillar One". Hadzovic *supra* note 639 at 55.
[641] Hadzovic *supra* note 639 at 54.
[642] *Ibid.*

in-scope ADS business types means that it could still reach most of the (tech) companies that are the focus of the taxation and digital economy reform.

(b) Nexus

Pillar One and Article 12B are both deviations from the traditional permanent establishment rule of business profits taxation. But that is, perhaps, as far as it goes in terms of their nexus similarity. For Pillar One, nexus is established when an in-scope MNE derives revenue amounting to at least €1 million from the source jurisdiction. Of course, this threshold drops to €250,000 if the source country is deemed a "smaller jurisdiction". The reasoning in Pillar One is that the threshold is necessary to limit compliance costs for MNEs as well as administrative costs for tax authorities.[643] The inclusion of *de minimis* thresholds seems quite reasonable, in principle, as a cost saver for taxpayers, as well as tax authorities. However, it is to be expected that some of the LIDCs that qualify as smaller jurisdictions may consider a €250,000 threshold too high for them, not to mention that some small market jurisdictions fall into the €1 million cohort. It is notable that the nexus threshold in Nigeria's domestic legislation, for instance, is a much lower figure of ₦25 million, which translates to about €54,000. A country like Nigeria might be expected to consider both Pillar One nexus thresholds unreasonable. The Pillar One thresholds may strip many LIDCs of what they consider significant tax revenue. When this nexus restriction is combined with the scope restrictions, we have a potentially more excruciating impairment of LIDCs' tax jurisdiction.

The alternative framework, Article 12B, does not impose any *de minimis* nexus thresholds. This makes Article 12B a potentially more attractive proposition for LIDCs as it allows for greater autonomy in the exercise of taxing rights by the market state. It also makes the ascertainment of

[643] OECD Two-Pillar Solution *supra* note 445 at 6.

the eligible market jurisdiction a more straightforward affair since there is no consideration for GDP fluctuations.[644] However, as I earlier posited, this deliberate omission does not preclude a state from inserting a nexus threshold either in its domestic law or tax treaty. From an LIDC perspective, a *de minimis* nexus threshold might be especially necessary to limit the burdens of tax administration, as well as to even the playing field for small and medium-sized enterprises who may not have sufficient resources, vis-à-vis larger MNEs, to meet the compliance requirements.[645] Therefore, I am of the view that the ideal structure, as far as nexus is concerned, lies somewhere between Pillar One and Article 12B. Pillar One does the right thing by inserting a nexus threshold, but, perhaps, falters by placing that threshold too high. For administrative reasons, Article 12B should contain a nexus threshold; although that issue is, perhaps, better resolved under the domestic legislation of each market state.

(c) Profit Allocation

Although both regimes would allocate profit to the market jurisdiction, the profit allocation mechanisms in Pillar One and Article 12B differ significantly. The first point of difference is that while Pillar One offers a net basis method of profit allocation, Article 12B offers both gross basis and net basis profit allocation options.

Pillar One (Amount A) allocates 25% of an MNE's residual profit to its market jurisdictions. Residual profit is defined as profit in excess of 10% of revenue.[646] This is, however, an arbitrary numerical definition that conveys neither the conceptual distinctiveness of residual profit nor the rational for its unique allocation to market jurisdictions. Implicit in Pillar One's profit allocation

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644 Hadzovic *supra* note 639 at 59.
645 See Vikram Chand & Camille Vilaseca, "The UN Proposal on Automated Digital Services: Is It in the Interest of Developing Countries?", *Kluwer International Tax Blog* (5 March 2021) online: https://perma.cc/TLR6-ZAHD.
646 OECD Two-Pillar Solution *supra* note 445 at 6.

scheme is the potential existence of more than one category of profits earned by an MNE, i.e., constituting total profits. Indeed, there are two such categories recognized by economists: routine and residual profits.[647] In the context of Pillar One, an MNE's total profits can be routine profits alone (where it is within 10% of revenue) or both routine and residual profits (the latter designation applicable only where and to the portion of profit that exceeds 10% of revenue). Of these two categories, based on Amount A, it is only the residual profit that is carved out and allocated to all market jurisdictions by the designated formula: sales.

Conceptually, routine profit is regarded as the profit that a third party would expect to earn for performing a given set of functions or activities, as if on an outsourcing basis.[648] Therefore, in the context of profit allocation, the tax system treats the MNE member entity as an independent third party or service provider performing a particular function or activity for the MNE group.[649] The supposed third party is deemed not to share in the overall risk of the multinational, and, therefore, earns no return based on the overall success or failure of the business.[650] It earns only an appropriate share of routine profits.

Generally, the routine profit can be ascertained by use of transfer pricing techniques[651] or by formulary apportionment.[652] With either approach, the objective is to reward the MNE member entity for the functions and activities that it undertakes as part of the integrated business of the MNE group. In other words, routine profit is deemed to emanate from the place where functions

[647] Michael P Devereux, *et al, Taxing Profit in a Global Economy* (Oxford: Oxford University Press, 2021); Reuven S. Avi-Yonah, Kimberly Clausing & Michael Durst, "Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split" (2009) 9 Fla Tax Rev 497; Sebastian Beer *et al,* "Exploring Residual Profit Allocation" (2020) IMF WP/20/49.
[648] Devereux *et al, ibid* at 201.
[649] *Ibid.*
[650] *Ibid.*
[651] *Ibid*.
[652] Avi-Yonah, Clausing & Devereux *supra* note 647; Beer *et al supra* note 647 at 5. In this case, a mark-up on the cost incurred by the relevant entity in performing its designated functions.

and activities take place, i.e., where the group's observable economic activities occur.[653] Such functions and activities may include R&D, general and administrative activities (G&A), manufacturing, marketing, and sales.[654] It is, therefore, implicit that routine profits are allocated for the supply side functions and activities in an MNE's value chain and can be calculated as a mark-up on the relevant entity's costs – based on the availability of data from comparable businesses.[655] Once profit is so allocated it can be taxed in the state where the relevant functions and activities are performed.[656]

The OECD's policy preference with respect to Pillar One is to allocate routine profits by transfer pricing – rather than formulary apportionment. This choice leaves the existing profit allocation model for MNEs largely intact. In other words, it leaves in place a *familiar* system of profit allocation (transfer pricing) where that system can be relatively effective (allocation of routine profits) and limits the adoption of a formula-based profit allocation system (unitary taxation) to situations where transfer pricing is less effective (residual profits).[657] Some scholars would prefer to apply formulary apportionment to both the routine and residual profits because they consider transfer pricing/separate entity taxation too complex and inefficient.[658]

Residual profit is simply defined as profit earned by an MNE that is in excess of routine earnings.[659] It may also be defined as the portion of total profits that exceeds a threshold that, usually, is designed to isolate a minimum level of profit from taxation.[660] Residual profit allocation

[653] Devereux *et al supra* note 647 at 203; Avi-Yonah, Clausing & Durst *supra* note 647 at 511.
[654] Devereux *et al ibid* at 189.
[655] *Ibid* at 203.
[656] Beer, *et al, supra* note 647 at 8.
[657] Devereux *et al supra* note 647 at 191 & 195.
[658] Avi-Yonah, Clausing & Durst *supra* note 647.
[659] Beer *et al, supra* note 647 at 5.
[660] Stephen E Shay, "The Deceptive Allure of Taxing "Residual Profits"" (2021) 75:11/12 Bulletin for Int'l Tax'n 1.

is a transfer pricing derived concept.[661] In this respect, residual profit allocation draws from the idea that an MNE's profits are produced by a synergy of different production factors cutting across the MNE's members (collectively) in different jurisdictions.[662] While some profits can be attributed to functions carried out by individual entities in the MNE group (routine functions) others go beyond the sum of what can be attributed to the contributions of individual entities in an open-market situation.[663] These non-routine, residual, or "excess profits" are difficult to pin down and are susceptible to manipulation by way of locating them in a jurisdiction with low tax exposure.[664] This is especially so where hard-to-value intangibles are involved.

The response of the international tax regime to this problem has been to improvise transfer pricing rules that streamline arm's length pricing especially in the case of intangibles and highly integrated group activities: transactional profit split method (TPSM).[665] Due to the inadequacy of regular transfer pricing methodologies, these rules leverage formulary elements to determine the appropriate intra-group reward from intangibles (profit split) by ascertaining the functions, assets, and risks deployed/contributed by each member.[666] This analysis leads to a conclusion that all jurisdictions where the contributing entities in the MNE are based contribute to the residual profit and should be entitled to tax it.[667]

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[661] Avi-Yonah, Clausing & Durst *supra* note 647; Devereux *et al supra* note 647 at 195; Beer *et al, supra* note 647 at 5.
[662] Avi-Yonah, Clausing & Durst *supra* note 647; Devereux *et al supra* note 647 at 195.
[663] Devereux, *et al, ibid.*
[664] *Ibid* at 195–196.
[665] See OECD, *Revised Guidance on the Application of the Transactional Profit Split Method* (Paris: OECD Publishing, 2018). See also OECD, *Guidance for Tax Administration on the Application of the Approach to Hard-to-Value Intangibles* (Paris: OECD Publishing, 2019); Vet, Cassimon & de Vijver *supra* note 19.
[666] Raffaele Petruzzi & Svitlana Buriak, "Addressing the Tax Challenges of the Digitalization of the Economy – A Possible Answer in the Proper Application of the Transfer Pricing Rules?" (2018) 72:4a Bull Int'l Tax'n 1; Vet, Cassimon & de Vijver *supra* note 19.
[667] See, generally, Devereux *et al supra* note 647 at 196.

Residual profit allocation in Pillar One adopts the formulary method enshrined in the TPSM, although with some marked differences. First, TPSM applies to specific transactions, which may be between some group members, not to the allocation of the unitary profit of an MNE group.[668] By contrast, residual profit allocation aims to calculate the residual profit at the level of the MNE group.[669] Second, profit splits apply only to MNEs with certain features, such as high-integration and core reliance on hard-to-value intangibles, while residual profit allocation applies to all MNE types, i.e., regardless of business model.[670] Third, a profit split would typically apply the full transfer pricing methodology to ascertain the routine profit, but a residual profit allocation scheme may not go so far. Some designs of residual profit allocation would instead set a fixed return on an entity's incurred expenditure regardless of the functions performed or risks assumed.[671] Finally, while the OECD profit split approach allocates taxing rights over residual profit based on the location of an asset or function, residual profit allocation schemes allocate taxing rights over these profits to market or destination countries.[672]

There are arguments to be made for why it is reasonable to limit Amount A profit allocation to residual profits. The obvious one, as Devereux opines, is that it preserves the reign of the familiar transfer pricing system with regard to the allocation of routine profits.[673] The distinction between routine and non-routine profits might be considered consistent with the notion that allocation of taxing rights to market jurisdictions is a "new" form of taxing rights, which, therefore, necessitates special treatment. This "new" form of taxing right rewards activities that are not part of the core chain of production, i.e., supply side activities.

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[668] Devereux, *et al, supra* note 647 at 196; Beer *et al supra* note 647 at 6.
[669] Devereux, *et al, ibid* at 197; Beer, *et al, ibid*.
[670] Devereux, *et al, ibid.*
[671] E.g., Avi-Yonah, Clausing & Durst *supra* note 647.
[672] See, generally, Devereux *et al supra* note 647 at 197–199.
[673] *Ibid* at 191–195.

However, there are also pungent reasons to be skeptical about this dichotomy. First, there is no clear discernment between routine and non-routine profits and the OECD's attempted distinction creates serious complexities and uncertainties in the ascertainment of respective profit categories.[674] Suffice it to state that the last thing LIDCs need is more complexity. Second, limiting the allocation of taxing rights to residual profits may cause discontent because the challenges posed by digitalization are by no means limited to residual profits.[675] Such limitation may tempt some market states to introduce unilateral levies on digital services in order to ensure a larger tax haul on business profits attributable to their market jurisdiction.[676] Third, implicit in the OECD's Amount A residual profit allocation approach is a supposition that a market state only contributes to the earnings of an MNE when those earnings exceed 10% of turnover. Does it mean that when an MNE's total profit does not exceed 10% of turnover – regardless of the actual nominal value of total profit – then none of that profit can be attributed to the demand side? I reason that attributing a fraction of the total profits to the market jurisdiction – rather than waiting until there are "residual profits" – is more consistent with the notion that the market is an integral component of an MNE's value chain and, therefore, always a source of total profit.

Finally, it seems entirely possible to allocate the total profit to both the demand and supply side – as components of an MNE's value chain – without the complex classification into routine and residual profits. One scholar has demonstrated that the limitation of Amount A to residual profits has no efficiency effect in itself, and that the same results can be attained by allocating a smaller

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[674] See Michael J Graetz, "A Major Simplification of the OECD Pillar 1 Proposal" (2021)101:2 Tax Notes Int'l 199 at 219; Devereux, *et al, supra* note 647 at 190 ["RPAI should also create less economic inefficiency and be less susceptible to tax avoidance than other RPA schemes, including that proposed by Avi- Yonah et al, although this does come at the price of greater complexity"].

[675] Pasquale Pistone, *et al,* "Comments by The International Bureau of Fiscal Documentation (IBFD) Task Force on the Digital Economy On the OECD Public Consultation Document "Secretariat Proposal for a 'Unified Approach' under Pillar One" (2019) at 3.

[676] *Ibid.*

percentage of total profits.[677] Therefore, there seems to be no tangible justification for this policy.[678] Instead, the utilization of residual profit allocation increases the complexity of Pillar One, "yields little or no net benefit", and might be motivated by some cynical reason.[679]

The more agitating question, especially from the view of LIDCs, is whether allocable residual profits should be limited and, if so, whether to a fraction of "only" 25%. Some scholars advocate that the entire residual profit should be allocated to market states.[680] Their reasoning has much to do with efficiency. Residual profit allocation (especially by the sale formular) is appealing for its presumed efficiency vis-à-vis the separate entity allocation that is inherent in the current system. Allocation of residual profit by sale is less susceptible to tax avoidance.[681] Destination-based allocation of residual profit is considered a most suitable yardstick because the third party purchasers or consumers are less mobile (especially in the case of individuals) which means that the formula is less susceptible to manipulation for tax avoidance, compared to other allocation formulas that rely on yardsticks like assets and employment.[682] After all, it has been argued, even in a high-tax state, companies have an incentive to maximize sales.[683]

The OECD compromise takes the path of allocating only a "small" fraction – 25% – of residual profits to market states. Although this might be considered less efficient and, perhaps, less

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[677] Shay *supra* note 660 at 6.
[678] Graetz *supra* note 674 at 219.
[679] Shay *supra* note 660 at 7 ["A cynic might take the view that the reason the OECD looked to residual profits was to make the allocation to market countries look like more than it is and to make it harder to expand the proposal to a broader group of companies. Irrespective of the allocation method, the small ambition of Pillar One is striking. Assuming that the average profitability of firms within the scope of Pillar One is 25%, a 25% reallocation percentage would reallocate no more than 3.75% of corporate profits to market countries. For these modest amounts, Pillar One should be drafted to be as straightforward as possible in implementation"]. See also Graetz *supra* note 674 at 219 [arguing that the OECD's decision to allocate only a portion of residual profit may be motivated by a reluctance to move swiftly – rather than incrementally – from existing profit splits, under the arm's length method that sometimes entitle the market state to only a share of the revenue from residual profits"].
[680] Avi-Yonah, Clausing & Durst *supra* note 647 at 509; Devereux *et al supra* note 647 at 192.
[681] Avi-Yonah, Clausing & Durst *ibid* at 509; Devereux *et al* supra note 647 at 190.
[682] Avi-Yonah, Clausing & Durst *ibid* at 509; Devereux *et al supra* note 647 at 190.
[683] Avi-Yonah, Clausing & Durst *ibid* at 509.

satisfactory to some market states, there are also equity justifications for not allocating the entire residual profit to market states. Graetz rightly iterates that a wholly destination-based allocation of non-routine profits is not justifiable because it would shortchange states that produce residual profits through production intangibles, headquarters activities, and R&D – as against marketing intangibles.[684] This, perhaps, explains why Pillar One aims to isolate the part of residual profit that is attributable to marketing intangibles – things like trademarks, customer lists, and user data – which can then be split between all market states by the sales formula.[685] It does seem a sensible compromise to me between different contributing factors to residual profit. However, the greater difficulty is agreeing on the right percentage of residual profit that should be taxed in the market state(s).

There is scarce information on how much revenue individual market states can expect to retain by virtue of Pillar One's 25% residual profit allocation scheme. While the OECD has claimed that Pillar One will realize revenues of up to $125 billion yearly,[686] the OECD has not provided a distributional chart for this aggregate revenue. Independent research by Devereux & Simmler puts the aggregate distributable sum at U.S.$87 billion, which is significantly less than the OECD estimate.[687] The civil society organization (CSO) Oxfam reckons that, using GDP as an indicator of market size, only about U.S.$0.6 billion of this estimated sum would be allocated to "low-income countries," while U.S.$31 billion would go to "middle-income countries".[688] If these amounts are taxed at an average rate of 25%, the tax revenue that accrues to "low-income countries" and "middle-income countries" is $140 million and $8 billion respectively (equivalent

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[684] Graetz *supra* note 674 at 220.
[685] Christians & Magalhaes, "Cooperative Surplus" *supra* note 520 at 22; Beer, *et al, supra* note 647 at 6.
[686] OECD Two-Pillar Solution *supra* note 445 at 2.
[687] Devereux & Simmler *supra* note 633.
[688] Didier Jacobs, "Are the Global Tax Proposals in the Interests of Low- and Middle-income Countries?", *Oxfam* (16 August 2021) online:

to 0.03% of their respective GDP).[689] Apparently, these are quite generous estimates, in the case of low- and middle-income countries, because a lot of the profits derive from information technology MNEs, for most of whom low- and middle-income countries represent a smaller consumption share.[690] These are remarkably small amounts, especially when accepting the deal means that LIDCs must give up digital taxes of their own, even on entities outside the scope of the deal.[691] African countries, through the African Tax Administration Forum (ATAF), proposed a tax rate of 35%,[692] while LIDCs under the G24 have stressed that anything short of a 30% allocation to market jurisdictions will not yield any palpable benefits to them.[693] These demands were not acceded.[694]

In October 2021, Oxfam produced an independent impact assessment of the potential revenue distribution of Pillar One for 52 developing countries.[695] Oxfam compared three different profit allocation rates under Pillar One with a 3% DST rate. A summary of Oxfam's findings is reproduced here:

- With the low 20% reallocation percentage, the net impact for developing countries could be negative. While the 52 developing countries for which we have data could gain around $1.43 bn. from Pillar 1, this would be less than the $1.66 bn. that we estimate a 3% DST could generate for these countries. The net effect could be an annual loss of $230 million to developing countries.

[689] *Ibid.*
[690] *Ibid.*
[691] OECD Two-Pillar Solution *supra* note 445 at 7. In a bid to assuage raging concerns amongst developing countries especially, the OECD has stressed that the termination does not apply to withholding taxes and other measures that are not equivalent to DSTs. It is, however, not been made clear where to draw the line of difference. Stephanie Soong Johnston, "Saint-Amans Rules Out 'Fantasies' on Digital Tax Rollback's Scope", *Tax Notes* (19 November 2021) online: https://perma.cc/PP4Q-3JQN.
[692] ATAF, "A New Era of International Taxation Rules – What Does This Mean for Africa?" (8 October 2021) online: https://perma.cc/5RN9-WFUJ.
[693] G24, "Comments of the G-241 on the Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy agreed by 134 jurisdictions of the Inclusive Framework on the 1st of July 2021" (19 September 2021) online: https://perma.cc/L2XX-FW2Q.
[694] See section 3.5.1 below.
[695] Oxfam, "The Effect of the OECD's Pillar 1 Proposal on Developing Countries – An Impact Assessment" (October 2021) online: https://perma.cc/M9EA-Z73U.

- The net impact of Pillar 1 with the higher 30% reallocation percentage mentioned in the OECD's July statement would be positive, but insignificant for developing countries. Comparing the revenue from Pillar 1 with a 30% reallocation percentage ($2.16bn.) with a 3% DST ($1.66 bn.) for developing countries shows that they could experience a net gain of around $494 million. This would be less than $10 million on average for each country, equivalent to just 0.007% of their GDP. Some countries would raise less than $1 million a year from Pillar 1, which may not be worth the administrative costs of implementation.
- Should negotiators adopt ATAF's proposal for a 35% reallocation percentage the net gain for developing countries could be more meaningful. The revenue generated from Pillar 1 with this reallocation rate ($2.54 bn.) would surpass the revenue from a 3% DST ($1.66 bn.) and produce a net gain for developing countries of $857 million. Although still low, this would be a significant improvement from the results using the OECD's suggested range of 20-30%.
- More detailed analysis for Kenya, Nigeria, Argentina and Mexico shows that lowering the revenue threshold from the current €20 bn. to €10 bn. could double the revenue for the four countries.
- Analysis for Kenya, Nigeria, Argentina and Mexico also shows that the single largest improvement to Pillar 1 would be to abolish the distinction between routine and non-routine profits, and instead apply the reallocation percentage to all profits and not just profits above 10% as suggested by the OECD July statement. For the four countries the removal of the 10% profitability threshold could increase the revenue by more than four times if the 35% reallocation percentage was used.[696]

The document speaks for itself. The revenue implications for LIDCs based on different rates of profit allocation is clear. The numbers are even more telling for countries like Kenya, Nigeria, Argentina, and Mexico if the distinction between routine and residual profits were extinguished.

I cannot fail to highlight another important takeaway from the Oxfam assessment, which is that while the negative revenue impact of Pillar One for most LIDCs does not seem too significant, compared to DSTs, for countries like Kenya, Nigeria, Argentina, and Mexico, halving the global turnover threshold would constitute a substantial amelioration of jurisdictional impairment. If halving the global turnover threshold would double the revenue for these countries, one can only

[696] *Ibid.*

imagine what eliminating that threshold and keeping only a nexus threshold can do. But does any of this information square with Article 12B?

I should highlight here that there is no equivalent impact assessment for Article 12B vis-à-vis the ones discussed above. However, since Article 12B offers both gross and net basis profit allocation options, I attempt to improvise a comparison, starting with the low hanging fruit: gross basis taxation. The gross basis tax is similar to a DST. Therefore, I am going to try to substitute Article 12B for the DST that Oxfam compares Pillar One with. It is helpful that Article 12B contains a withholding tax rate recommendation of 3% or 4%.[697] Assuming that a 3% rate is adopted, it seems that the only situation where a gross-based Article 12B beats Pillar One is if only 20% of residual profits were allocated to market states. The results should be similar in the case of a 25% allocation. This means that there is no clear advantage of Article 12B, at least in terms of the amount of revenue that is available to tax in the market state. The main attraction of the Article 12B gross basis approach, therefore, seems to be its relative administrative simplicity. LIDCs are generally conversant with the withholding tax system.[698] On this point, the commentary explains that:

> Many developing countries have limited administrative capacity and need a simple, reliable, and efficient method to enforce tax imposed on income from services derived non-residents. Withholding tax imposed on the gross amount of payments made by residents of a country, or non-residents with a permanent establishment or fixed base in the country, is well established as an effective method of collecting tax imposed on non-residents. Such a method of taxation may also simplify compliance for enterprises providing services in another State since they would not be required to compute their net profits or file tax returns, unless they themselves opt for net income basis taxation.[699]

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[697] See the Commentary on Article 12B, UNTC, paragraph 4. The low rate is largely informed by the need to limit the likelihood of double taxation. While a low withholding tax rate may not extinguish the risk of double taxation, it keeps it at a minimum level.

[698] Oguttu notes earlier that "the BEPS project does not explore certain practical measures (such as withholding taxes) which may be more suitable for African countries in addressing BEPS." See Annet Wanyana Oguttu, "Tax Base Erosion and Profit Shifting in Africa – part 1: What Should Africa's Response be to the OECD BEPS Action Plan?" (2015) 48:3 The Comp & Int'l LJ Southern Africa 516 at 551. The withholding tax option is retained in ATAF's Suggested Approach which buttresses the point that this system enjoys the particular support of African countries.

[699] See the Commentary on Article 12B, paragraph 5 UNTC.

Its simplicity appeal notwithstanding, the policy of gross-basis taxation of business profits from ADS must be considered fundamentally problematic. Because it does not account for substantial expenses incurred by taxpayers, gross-based taxation is mostly considered a viable option for the enforcement of passive income taxes, e.g., interest, dividend, and royalties.[700] Article 12B's reliance on gross-based taxation for active business income may result in excessive taxation[701] and in some cases may be passed on to consumers.[702] Mehboob observes that while some entities are willing to pass on the tax cost to consumers, some others may be willing to avoid the same price hike to retain their market share.[703] The likelihood of passing on to consumers is lower in respect of Pillar One because Pillar One is enforceable on a net basis and at the consolidated group level.

It is, therefore, comforting that Article 12B contains an inbuilt mechanism that enables an entity that is at risk of double taxation to limit that risk. Paragraph 12B(3) provides for net basis taxation of a non-resident entity, where that entity elects to be so taxed. This provision is a bit similar to Pillar One because it allocates only a share of net profits – known as "qualified profits" – for taxation in the market jurisdiction. The qualified profits rule would apportion 30% of an entity's income from ADS to the market countries. Some commentators contend that a net income election can relieve unnecessary tax burdens on low margin or loss-making companies, but that relief can only be obtained at significant administrative costs.[704] I do not disagree with this assessment, especially as it concerns smaller companies. Perhaps, the only way to cushion the effect is to limit Article 12B to companies with a designated revenue-based nexus threshold. This would ensure

[700] Tripathi & Mehta *supra* note 629 at 1.
[701] Chand & Vilaseca *supra* note 645.
[702] Danish Mehboob, "UN Digital Tax Proposal Diverges from OECD Two-pillar Solution", *Int'l Tax Rev* (17 August 2020).
[703] *Ibid.*
[704] Comments from Digital Economy Group (Baker McKenzie) on Proposed UN Article12B of the UN Model Tax Convention at 5; Hadzovic *supra* note 639 at 64.

that only entities with significant revenue are subject to the administrative cost. Based on the current framework, non-resident entities with small sales in the market state may be forced to either accept a gross based tax, push the tax to the customer, or exit the market. It is hard to imagine that the tax raised from such small transactions justifies the administrative burden.

Further, Tripathi & Mehta argue, rightly, in my view, that the net basis tax option inserted in Article 12B may turn out to be largely redundant because it might require an MNE operating in multiple market jurisdictions to compute "qualified profits" in accordance with the laws of each jurisdiction. This situation poses administrative obstacles and significant compliance costs, that may force MNEs to opt for a less favorable gross based taxation.[705]

Without a revenue impact assessment of Article 12B net basis taxation, it is difficult to form a clear opinion on its merits vis-à-vis Pillar One. However, my impression is that Article 12B's profit allocation more closely mirrors the more "generous" levels of allocation that Oxfam estimates with respect to Pillar One. This is especially so because Article 12B allocates a direct share of total profit ("qualified profits"), at a huge rate of 30%, which seems to be, potentially, much more significant than the Pillar One's allocation of residual profits only.[706] Also, unlike Pillar One, Article 12B does not require that an entity hit a certain threshold of profitability before it can be taxed in the market jurisdiction. I sense that these profit allocation variables would bring things closer to ATAF's 35% reallocation proposal. Although still low, such allocation would be a significant improvement on Pillar One's 25%. The results might be even more remarkable for countries like Kenya and Nigeria given that there is no global turnover threshold in Article 12B.

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[705] Tripathi & Mehta *supra* note 629 at 1–2.

[706] The qualified profits are allocated almost entirely on a formulary apportionment basis, with sales, assets, and employees receiving equal weights of 30%. See Commentary of Article 12B, para 51.

The UN Committee asserts that the allocation is inspired by a desire for certainty and fairness.[707] The committee explains that:

> The specific figure of thirty percent is adopted by the Committee to achieve certainty on the one hand and to provide a fair and reasonable share to both jurisdictions on the other, keeping in view the special role markets play in generation of profits from the activities under the scope of the Article.[708]

The committee also outlined that the respective roles of assets, employees, and revenue in revenue generation were assigned equal weight.[709] I think that while an arbitrary numerical allocation can be readily justified on grounds of certainty, the same cannot be said of fairness. Without an impact assessment (whether from the UN or independent researchers), it is difficult to see a principled justification for the market state 30% allocation.[710] This, perhaps, explains the concerns, even amongst "a large minority of members" of the committee, that 30% of qualified profit *may* be too high.[711] There is no stipulation of what percentage these minority members consider appropriate, but it appears that their preference was for the rate to be negotiated on a bilateral basis.[712]

Adding to these concerns, Tripathi & Mehta demonstrate, with simulations, that the equation used for the ascertainment of qualified profits is hugely distortive. In some cases, the equation produces significant disparities and disproportionate mismatches between profitability ratio and tax liability in each taxable jurisdiction.[713] These concerns are impossible to ignore, both from perspectives of equity and efficiency.

[707] Commentary on Article 12B, para 50.
[708] *Ibid.*
[709] *Ibid.*
[710] Tripathi & Mehta *supra* note 629 at 7–8.
[711] Commentary on Article 12B, para 41.
[712] *Ibid.*
[713] *Ibid* at 8 ["For example, while in Country C, ABC Inc. was able to factually achieve a local profitability ratio of around 85%, but only 25% of the profits generated will be taxed therein. Similarly, while the local profitability ratio of ABC Inc. in country B was merely 25%, almost 85% of the total local profits generated therein will be brought to tax."].

Finally, Pillar One has an edge over Article 12B in terms of their respective segmentation policies. Pillar One does not allow segmentation between business lines unless in exceptional cases. This is consistent with the broad business line scoping of Pillar One. The implication is that where an MNE is involved in different lines of business, its turnover would be computed on a consolidated basis and taxability would be assessed on the group basis. Article 12B, on the other hand, focuses on ADS and, perhaps, for this reason, requires segmentation of the ADS business from the MNE or beneficial owner's aggregate business. The requirement of segmentation poses serious administrability challenges,[714] which is, perhaps, why a number of LIDCs, including ATAF, pushed for a no segmentation framework during Pillar One negotiations.[715] It seems counterintuitive that LIDCs would prefer the segmental complexity of Article 12B.

Article 12B represents an interesting alternative to Pillar One. In some respects, it might be considered a preferable option for LIDCs, or at least for the likes of Kenya, Nigeria, Argentina, and Mexico, who may be more disenchanted with some of the restrictions in Pillar One. Pillar One's scope, nexus, and profit allocation specifications all appear to be more restrictive than Article 12B. From an administrative perspective, Article 12B also offers greater convenience for LIDCs because of the availability of the withholding tax option. Its identified flaws notwithstanding, the existence of an alternative that is, on the surface, noticeably less restrictive (at least for some LIDCs), but which also provides an (imperfect) avenue for addressing the attendant problem of double taxation, chips away at the logic of adopting a framework that is more restrictive on tax jurisdiction and, potentially, reinforces the subsisting pro-residence country bias of the international tax regime. However, Article 12B also comes with some potential neutrality

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[714] Anjana Haines, "Corporate Segmentation Holds the Key to Pillar One Blueprint", *Int'l Tax Rev* (3 September 2020) online: https://perma.cc/UAM6-MWJH.

[715] Discussed further in section 3.5.1.

and administrability baggage, which ought to be addressed before it can be deemed an alternative that is worth supplanting a multilateral solution like Pillar One. An impact assessment – but obviously not that alone – would go a long way to address the inherent concerns.

3.4.3.3 Potential for Non-Tax Benefits

One argument that has been made against unilateral digital taxes is that they might discourage investment in the technology market of countries that impose them.[716] This is part of the argument that the U.S. Chamber of Commerce, for instance, has advanced in opposition to Canada's DST proposal.[717] Taxes should not distort efficient behaviour, especially in a sector that is heavy on investment and innovation. After all, the incredible productivity that is brought about by digitalization would be unimaginable without substantial investment in hardware, software or digital platforms.[718] This explains why DSTs, as a withholding tax on digital transactions, may be frowned at for their potential to discourage innovation and investment, especially for young and low-margin businesses who may be unable to absorb potential losses from a tax on gross revenue.[719] Therefore, on the face of it, it seems that an international tax compromise like Pillar One, which is meant to displace DSTs and any turnover taxes, limits potential tax barriers to innovation and investment. Yet, even if we embrace these arguments, it is one thing to conclude that unilateral measures like DSTs are distortive and counter-innovative, and another thing to conclude that states should accept the restrictive Pillar One deal because it is potentially more beneficial to them in non-tax respects. There are lots of questions to be

[716] Jack Purcher, "U.S. Chamber of Commerce Urges the Trump Administration to Block Canada's Proposed France-Styled Tax on U.S. Tech Companies", *Patently Apple* (15 November 2019) online: https://perma.cc/P3E8-4N94.
[717] *Ibid*; Kevin Pinner, "US Chamber Says Canada's Proposed Digital Tax Risky for Biz", *Law 360* (10 December 2021) online: https://perma.cc/7V3B-2BWV.
[718] Smith & Spengel *supra* note 412.
[719] Barry Larking, "A Review of Comments on the Tax Challenges of the Digital Economy" (2018) Tax Notes Int'l 17 at 20–21.

answered in this regard. Will giving up taxing rights, to the extent contemplated in Pillar One, stimulate, or enhance non-tax benefits for LIDCs? What kinds of non-tax benefits will ensue from the deal and how will they flow to LIDCs? Do the anticipated non-tax benefits outweigh or compensate for the cost of tax revenue losses? Would such non–tax benefits not ensue absent the tax deal or if the tax deal were not as restrictive? Also, are there non-tax disadvantages that may accompany the deal? These are pertinent questions that require answers that are based on economic analyses. But even from an imprecise assessment, there seems to be a lot of weighing and balancing.

Pillar One is all about taxation in market states. It limits the extent to which a market state can tax income derived by non-resident businesses (mostly digitalized). Yet, it is difficult to fully appreciate how the deal might benefit market states in a non-tax sense. Take investment, for instance, does the deal enhance the prospects for digitalized and other remote business models to increase their investment in digital assets or infrastructure in LIDCs, as market states? One study suggests that because digital business models tend to be highly mobile, tax factors might play an important role in their choice of where to invest.[720] However, this conclusion is based on an assessment of where digital business models locate their pre-market (supply side) activities and assets such as R&D, software and IT hardware.[721] It finds that the tax treatment in the location of these supply side factors is decisive of overall tax burdens, regardless of the tax treatment in the market state.[722] But, this is distinct from the question of how tax policy in a

[720] Marcel Olbert, Christopher Spengel & Ann-Catherin Werner, "Measuring and Interpreting Countries' Tax Attractiveness for Investments in Digital Business Models" (2019) 47:2 Intertax 148.
[721] *Ibid* at 153.
[722] *Ibid* at 153 & 156 ["Regarding the international expansion in the B2C and B2B sector, digital business models operate slim organizational structures with only few activities and assets such as minor administrative personnel or the use of IT infrastructures and data centers in the market countries. Consequently, only a small share of the total profits is allocated to the local entities and the principal taxable nexus arises at the main location of the parent company according to current rules of taxation.'… The results of the cross-border digital business models differ from

market state might influence the willingness of non-resident digitalized businesses to invest in, say, the digital infrastructure of that state. If digitalized businesses invest in digital assets, e.g., broadband infrastructure, to enhance digital access/integration in lower-income market states, then it becomes more sensible to draw links between a tax compromise that limits their market state tax exposure and such investment decisions. Armed with such information, states like Nigeria and Kenya, for instance, may be convinced to embrace a tax deal like Pillar One with the prospect that digital streaming giants such as Netflix and Showmax would plough some of their capital or revenue into the film industry in those countries[723] even if these companies do not meet the €1 million nexus threshold. However, for Nigeria and Kenya to make that "revenue sacrifice" they must be well apprised that the trade-off is both necessary for the investment to take place and worth the revenue that is surrendered.

In October 2021, not long after a framework for the Pillar One deal became public knowledge, digital business giant Google announced a plan to invest $1 billion in Africa over five years.[724] A substantial quantum of Google's investment will go to digital infrastructure, including a transnational subsea cable, to improve internet connectivity, while some will fund tech business innovation.[725] Google hopes that these investments will: (1) enable affordable internet access; (2) help businesses with their digital transformation; (3) spur next generation technologies; and (4) improve lives on the continent through support for non-profits.[726] Google's investment is

the results of the domestic case since a further level of taxation arises In the market countries. The tax burden, however, still largely depends on the tax regime in the parent company's country since the relevant investments and activities are carried out at the main location."].

723 Gbemileke Babatunde, "With Huge Investments into African Originals, are Netflix and Showmax Taking too Big a Risk?", *Tech Next* (14 January 2021) online: https://perma.cc/W5B6-W8QP; Scott Roxborough, "Why the Streamers Are (Finally) Investing in Africa", *Hollywood Reporter* (17 January 2022) online: https://perma.cc/6T29-NTYV.

724 Sundar Pichai, "Our $1 Billion Investment in Africa's Digital Transformation", *Google Blog* (6 October 2021) online: https://perma.cc/W47F-RM5W.

725 Daniel Renjifo, "After $1 billion Investment, Google Pledges to Build a More 'Vibrant and Dynamic' Digital Ecosystem in Africa", *CNN* (29 November 2021) online: https://perma.cc/A9D7-VJT8.

726 Pichai *supra* note 724.

expected to contribute to digital integration in Africa, as the company projects that over 300 million more people on the continent will "come online" over the following 5 years.[727] Google's investment can be deemed especially important because a significant chunk targets the demand side, i.e., the market jurisdiction.

A similarly ambitious connection project is being undertaken by another digital giant, Facebook, in consortium with a few other tech companies.[728] Having launched the project in 2020, in September 2021, Facebook announced the extension of its planned 2Africa cable subsea cable to connect 33 countries across three continents – Africa, Europe, and Asia.[729] At 45,000 kilometers, 2Africa is expected to become the longest subsea cable in the world.[730] Facebook's investment has a common objective with Google's – bring more people online, and that includes Africa's 1.2 billion people.[731] The cable is projected to triple the network capacity of the subsea cables currently serving the African continent.[732] The project is estimated to be ready in 2023.[733]

Investment in digital infrastructure, such as subsea cables, can enhance access to digital services for end users in the covered market states. It is worth stating that while most digitalized businesses tend to invest mainly in supply side assets and activities,[734] investment in the demand

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[727] Sean Keane, "Google will Invest $1 Billion in Africa in the Next Five Years", *CNET* (6 October 2021) online: https://perma.cc/9KTM-RSEE.
[728] Najam Ahmad & Kevin Salvadori, "Building a Transformative Subsea Cable to Better Connect Africa", *Engineering at Facebook* (13 May 2020) online: https://perma.cc/N3W6-LQ26.
[729] Tage Kene-Okafor, "Facebook-backed 2Africa set to be the longest subsea cable upon completion", *TechCrunch* (29 September) online: https://perma.cc/HXP5-6XKW.
[730] *Ibid.*
[731] *Ibid.*
[732] Kevin Salvadori, "2Africa Pearls Subsea Cable Connects Africa, Europe, and Asia to Bring Affordable, High-speed Internet to 3 billion People", *Engineering at Meta* (28 September 2021) online: https://perma.cc/58XZ-UX37.
[733] Katie Collins, "Facebook-backed Consortium Expands Plans for World's Longest Subsea Cable", *CNET* (28 September 2021) online: https://perma.cc/L25V-YKS9.
[734] See Olbert, Spengel & Werner *supra* note 720.

side is also important because of the essentiality of demand side digital assets in maintaining and expanding the market.[735]

The Pillar One deal is expected to cover the "top 100" most profitable MNEs in the world.[736] Google (Alphabet) and Facebook (now Meta)[737] are two of the in-scope MNEs, at least in terms of their annual revenues.[738] Considering the timing announcement, African countries involved in the OECD Inclusive Framework might be tempted to consider whether the investments by Google and Facebook are signs of things to come, especially given that the continent lags behind in digital transformation.[739] It remains a fundamental question, however, as to whether there is a concrete link between the deal and these MNEs investment decisions. In other words, how much of an impact did the Pillar One compromise have on the MNEs' investment decisions? It is difficult to tell. Facebook's project was first announced in May 2020, more than a year before the OECD-led compromise.[740] Perhaps, it is best to accept the obvious explanation: the projects represent long-term investments for two rational businesses. A November 2020 report jointly published by Google and the Word Bank's International Finance Corporation (IFC) finds that Africa's internet economy has the potential to reach 5.2% GDP by 2025, i.e., $180 billion ($750

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[735] See Luis Valdes, "Is Existing Digital Infrastructure A Constraint on Recovery?" (2021) 390:6 FAL Bull 1.

[736] Sam Meredith, "G-20's Global Crackdown Could Create a New Kind of Tax Haven", *CNBC* (16 July 2021) online: https://perma.cc/432Z-NL4R. However, as Devereux & Simmler show, the number should be in the region of 70. Devereux & Simmler *supra* note 633.

[737] Salvador Rodriguez, "Facebook Changes Company Name to Meta", *CNBC* (28 October 2021) online: https://perma.cc/5SZD-YML8.

[738] Fortune, "Global 500" (2021) online: https://fortune.com/global500/2018/search/.

[739] IFC, "Bringing Africa up to High Speed" online: https://perma.cc/R86H-49N8. The EU also recently announced plans to invest at least €820 million ($927.5m) in the digital transformation of Nigeria (Africa's largest population). The investment is a combination of €160 million ($180.9m) in grants and €660 million ($746.6m) in loans over two years. It is part of a greater €150 billion African investment package that is designed to rival China's Belt and Road initiative. Dan Swinhoe, "EU Announces €150 Billion African Investment Package, Will Fund Data Center and Cable Projects", *Data Center Dynamics* (14 February 2022) online: https://perma.cc/644E-VKR2; Jan van der Made, "Europe Counters China's Belt and Road Strategy with Plans for €150 Billion Investment in Africa", *RFL* (11 February 2022) online: https://perma.cc/5YHU-22Q2.

[740] Ahmad & Salvadori *supra* note 728.

billion by 2050).[741] The report identifies faster and better quality internet access, rapid urbanization, a growing tech talent pool, a vibrant start-up environment, and a continental single marker regime as some of the drivers of the growth.[742] Google also relies on an external study that equates a 10% increase in mobile internet connectivity with a 2.5% GDP per capita increase in Africa.[743] These permutations indicate that Google's investment is, at least in part, motivated by perceived opportunities in the African digital economy; and Google is positioning itself to exploit these opportunities.[744]

Google does not cite the Pillar One tax deal or taxation, generally, as a factor in its decision to invest in Africa. Thus, it is not clear, despite the timing, that tax was a substantial consideration. Given how long, presumably, it takes to make decisions on such substantial investment, it seems likely that the timing of announcement was coincidental. That notwithstanding, some critics argue that Google's $1 billion 5-year investment is not commensurate with the amount of tax that the company avoids paying on the continent due to the subsisting international tax regime.[745] Carlos Lopes, a professor in the Mandela School of Public Governance at the University of Cape Town, South Africa, and former secretary general of the United Nations Economic Commission for Africa (UNECA) regards the investment as "peanuts", remarking that: "*Google does not pay taxes in Africa. If it did it would be probably way above the $250 million a year offered here*".[746]

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[741] Google & IFC, *e-Conomy Africa 2020: Africa's $180 billion Internet Economy Future* (2020).
[742] *Ibid.*
[743] Mimi Mefo Takambou, "Queries over Google's planned billion-dollar investment in Africa", *DW* (20 October 2021) online: https://perma.cc/9UVK-MTWM.
[744] Google's ramped-up investment has also attracted criticism from skeptics. One criticism is that the investments in tech start-ups merely gives Google and other big tech companies the platform to acquire profitable tech start-ups from Africa. Another line of criticism questions the overall impact of the investment considering that it primarily focuses on only 4 out of 54 African countries (Nigeria, Ghana, Kenya, and Uganda). See Takambou *ibid*.
[745] See Shoshana Kedem, "Google's $1bn Africa Investment Sparks Tax Debate", *African Business* (7 October 2021) online: https://perma.cc/3GY4-2N93.
[746] *Ibid.*

There is no doubt that MNEs like Google and Facebook have tremendously benefited from a global economic order that facilitates non-taxation of non-resident digitalized businesses; an economic order that includes a WTO moratorium on tariffs for digital trade (in place since 1998).[747] Considering the these MNEs' enduring status as global players, it is conceivable that if they were inundated with global taxes – especially turnover taxes – and transnational administrative burdens (quite possible under Article 12B) during their formative or pre-profit years, they would not have reached the status of profitability that enables them to make the kinds of huge investments discussed here, including investments in LIDCs. Perhaps, this is where a tax compromise like Pillar One is vital to the survival and expansion of out-of-scope MNEs.

It is not my intention to equate non-tax benefits with physical infrastructure or FDI, like the kind expended by Google and Facebook. Sometimes, by their mere remote "presence" in a country, digitalized businesses have the potential to confer positive impacts on that country's economy by, for instance, enabling reverse or outward market access expansions for local businesses and providing avenues for economic integration between local businesses. Reverse market access may take the form of Netflix facilitating the Nigerian movie industry's penetration of global film markets[748] or music streaming businesses like Spotify providing Nigeria's musical artists a greater platform to disseminate their contents globally and to gain unprecedented levels of global

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[747] See WTO, "Declaration on Global Electronic Commerce" (25 May 1998) WT/MIN(98)/DEC/2. The moratorium is reportedly worth an estimated $225 billion per year and is renewed regularly. See Emma Farge, "WTO ban on tariffs for digital trade extended until June 2020", *Reuters* (10 December 2019) online: https://perma.cc/7PKR-739C. Estimates by the UNCTAD on a few digitalized goods (printed matter, music and video downloads, software and video games) reveals a tariff revenue loss of $10 billion. However, 95% of the loss is borne by developing countries. See UNCTAD, *Rising Digitisation and Losing Trade Competitiveness* (New York: United Nations, 2017) online: https://perma.cc/YB79-8P7P; UNCTAD, "Growing Trade in Electronic Transmission: Implications for the South" (2019) UNCTAD Research Paper No. 29.

[748] Añulika Agina, "Netflix and the Transnationalization of Nollywood", *Post45* (13 April 2021) online: https://perma.cc/8G9N-RCYV; Wilifred Okiche, "Netflix Isn't the Savior Nollywood Needs", *The Verge* (13 August 2021) online: https://perma.cc/HP5A-5ZG9 ["Netflix has listed titles like Òlòtūré, Citation, and The Delivery Boy as some of the most viewed Nollywood content of 2020, not just in Nigeria, but in overseas territories as well."].

recognition.[749] These benefits accrue regardless of whether these companies pay Nigerian taxes, and can stimulate positive socio-economic effects for Nigeria, including employment opportunities.[750]

An example of the former is the social media enterprise Twitter. The company does not have a physical location in Nigeria[751] and, historically, has not paid tax in Nigeria,[752] despite boasting millions of users in the country.[753] In June 2021, following a dispute between the Nigerian government and Twitter over a controversial tweet by Nigeria's President, which Twitter removed from its platform, the Nigerian government restricted access of Nigeria's internet users to Twitter.[754] The restriction reportedly cost the Nigerian economy a whopping $26 billion (6%

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[749] See Anthony Udugba, "Streaming market keeps Nigerian artistes afloat amid constraints", *Business Day* (8 November 2021) online: https://perma.cc/ER2X-FLG3 ["PricewaterhouseCoopers projects that Nigeria would be the world's fastest-growing entertainment and media market (E&M) with a 12.1 percent compound annual growth rate (CAGR) over a five-year period (2017-2021). The report also says that the total revenue that will be generated by all the players in Nigeria's E&M industry is expected to rise from $7.68 billion in 2021 to $9.03 billion in 2022, to $10.66 billion in 2023, and will increase further to $12.56 billion in 2024 before settling at $14.82 billion by 2025, culminating to an average growth rate of 18 percent during that period. The streaming services such as Boomplay, Spotify, Audiomack, YouTube, etc are enabling an environment in which Nigerian creatives including music artists of all genres can not only reach a wide audience but also monetise their content. Before now the only way an artist could earn money was to be invited to perform in a music show or sell their songs to marketers at Alaba or Onitsha."]. See also, Ronke Idowu, "2022 Grammy: Wizkid, Femi Kuti Get Double Nominations, Burna Boy Makes List", *Channels TV* (24 November 2021) online: https://perma.cc/28KG-S6NH; Funmilayo Kanmodi, "Ckay Goes Platinum In The United States Alongside Wizkid And Tems", *Not Just Ok* (24 January 2022) online: https://perma.cc/BR2B-ZP23.

[750] Pius Dukor, "Music Alone Can Generate Employment More Than Oil, Gas – PMAN President", *Business Day* (10 December 2021) online: https://perma.cc/H4WQ-W958; Victor Terhemba, "Solving Unemployment with the Creative Industry", *Modern Ghana* (8 October 2021) online: https://perma.cc/Q74R-59WA; Aisha Salaudeen, "Nigeria's Social Media Comedians are Making Laughter Pay", *CNN* (6 August 2021) online: https://perma.cc/6DPK-3W22. Also, Whownskenya, "Top 20 Highest Paid Comedians in Kenya and Number of Subscribers" (14 October 2021) online: https://perma.cc/KFH6-HKHJ.

[751] In April 2021, Twitter announced the opening of its first African headquarters in Ghana, despite having an estimated 39.6 million users in Nigeria, more than the 32-million-person population of Ghana. The decision was attributed to a number of factors, including Ghana's ease of doing business and deeper democratic values. See Nimi Princewill & Stephanie Busari, "The new 'jollof wars' and why Twitter chose Ghana over Nigeria for its first Africa base", *CNN* (14 April 2021) online: https://perma.cc/R45Z-DJGC.

[752] Samuel Nwite, "Nigeria's Digital Tax and the Twitter Ban", *Tekedia* (7 January 2022) online: https://perma.cc/J8XL-CU9F.

[753] NOI Polls, *Social Media Report* (November 2019) online: https://perma.cc/KJ2L-HKAT.

[754] David Thomas, "US dismay as mobile networks told to enforce Nigeria Twitter ban", *African Business* (4 June 2021) online: https://perma.cc/ZT69-P3HP.

of GDP).[755] Much of these losses fell on Nigeria's online vendors, many of whom transact on the platform, and many of whom pay taxes to the Nigerian government.[756]

The Twitter example underscores the point that digitalized businesses can contribute significantly to a country's economic fortunes even when they neither reside nor pay tax in that country. This perspective should, of course, not be viewed as a sweeping endorsement of the non-taxation of such entities. It only contends that there may be instances where it makes economic sense to tolerate the continued operation of a non-resident digitalized business even if the business does not contribute directly to the market state's treasury. This is especially so in the case of entities that contribute to a country's economy but are not themselves profitable. An example, again, is Twitter, which did not turn profitable despite 12 years of existence and global operations, until that situation changed in the first quarter of 2018.[757] Other prominent examples include the popular music and podcast streaming service, Spotify, which became profitable in 2018 after more than a decade of operation and substantial investment[758] and Uber Technologies, the ride-sharing and food-delivery enterprise, which posted a quarterly profit for the first time in 2021.[759] These enterprises provide important and transformational services to the global economy even when they have not been profitable.[760]

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[755] Shoshana Kedem, "Nigeria Lost $26bn to Twitter ban, Businesses Say", *African Business* (18 January 2022) online: https://perma.cc/9QBT-JXCC.

[756] Timothy Obiezu, "Nigeria's Online Vendors Count Losses After Long Twitter Ban", *VOA News* (21 January 2022) online: https://perma.cc/27Y6-5DD4.

[757] Hayley Tsukayama, "Why Is Twitter Now Profitable for the First time Ever", *The Washington Post* (8 February 2018) online: https://perma.cc/J2WU-4RAJ ; Kurt Wagner, "Twitter Just Reported Its First Profitable Quarter Ever, but Didn't Add New Users in Q4", *Vox* (8 February 2018) online: https://perma.cc/77BC-EQ7C.

[758] Amy X Wang, "Spotify Turns a Profit for the First Time — and Reveals Its Bigger Ambitions", *Rolling Stone* (6 February 2019) online: https://perma.cc/25KC-AB5E.

[759] Eric J Savitz, "Uber Posted Its First Profitable Quarter. What to Know", *Barrons* (4 November 2021) online: https://perma.cc/RR89-ZSTJ.

[760] Ailey Butler, "Why Streaming is a Good Thing for the Music Industry" (2019) 2:1 Backstage Pass, online: https://perma.cc/4U4P-UDBX; Shira Ovide, "Streaming Saved Music. Artists Hate It", *New York Times* (22 March 2021) online: https://perma.cc/JE6J-CQE2; Laura Miller, A Look at Uber's Impact on Canada's Economy", *Canadian*

The Twitter-Nigeria situation is just one example where a state might be justified in allowing a non-resident entity to operate in its territory despite that entity not paying tax there. It remains a lingering question whether there is strong justification for an international compromise that excludes most entities from taxation of their foreign source income as a measure of encouraging non-tax benefits such as innovation and investment. Put differently, even if the Pillar One tax deal, with its implicit tax revenue sacrifice, comes with the attraction of greater FDI or other non-tax benefits, should a state not be entitled to determine whether it prioritizes those non-tax benefits and how it wants to channel tax incentives? For instance, Nigeria's insistence that Twitter open an office in Nigeria, appoint a Nigeria country representative, and pay tax in Nigeria suggests that the country prioritizes tax revenue from Twitter as much as it may appreciate the other contributions that Twitter makes to the Nigerian economy.[761] Declining an international tax compromise that reinforces a system of wholesale source non-taxation might seem more sensible for a state that wishes to achieve the dual objectives of tax revenue and non-tax benefits because not every company invests in its foreign market or brings about other substantial non-tax benefits the way that Facebook, Google, and Twitter do. A more nuanced approach allows a state to provide tax relief to those companies that are willing to invest, while simultaneously guarding against free riders who might take advantage of a universal system of non-taxation. In a system of fiscal self-determination, where states can concede taxing rights on a case-by-case basis – as is often the case with tax incentives – source states might be better

Chamber of Commerce (31 May 2021) online: https://perma.cc/9GCP-ZJMC; "What is Driving Uber's Global Impact", *Green Economy* , online: https://perma.cc/5FKD-WWYR.

[761] Nigeria recently announced that, as part of conditions for the reapproval of Twitter access in the country, the company agreed to register in Nigeria, appoint a Nigerian country representative and to pay tax in Nigeria. Nduka Orjinmo, "Twitter Agrees to Nigeria's Demands to End Seven-month Ban", *BBC* (13 January 2022) online: https://www.bbc.com/news/world-africa-59958417. In April 2022, Twitter confirmed to the BBC that the company has "registered a legal entity in Nigeria". BBC Africa, "Twitter Confirms it has Registered in Nigeria", *BBC Africa* (28 April 2022) online: https://perma.cc/MK36-ASPC.

placed to attract and streamline in-bound benefits. For instance, the African countries that stand to benefit from Facebook and Google's investment in digital infrastructure may choose to grant those companies certain tax reliefs over a specified period, as a trade-off for the investment. The current deal – which may not directly benefit Facebook and Google because of these companies' status as in-scope MNEs – more likely benefits free riders who may be out-of-scope despite having substantial economic involvement in certain market countries.

Perhaps, the best way to approach the non-tax benefits component with regard to Pillar One is to view such benefits, not just in terms of what each state can directly gain in exchange for the tax concession – given how undiscernible that might be – but in terms of its facilitation of the overall growth of the digital ecosystem. The "interim" loss of tax revenue is compensated by limited distortions to investment and innovation, which ultimately advances digitalization to the benefit of all. Tax burdens tend to more negatively affect the investment choices of small firms than highly profitable ones.[762] Therefore, the big firm focus of the deal has the potential to benefit smaller tech enterprises from LIDCs who may want to expand their operations beyond their national borders in an ever growing and integrated digital economy.[763] It is one thing for Kenya and Nigeria to tax Spotify, a global streaming giant; but their policymakers should also consider the potential economic implications of a more open system where Kenya and Nigeria can impose

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[762] Zoe Andrews, "International Tax Reform – Winners and Losers", *European Tax Blog* (16 October 2020) online: https://perma.cc/F2ZU-UAKS.

[763] See Ubah Jeremiah Ifeanyi, "Nigerian Tech Startups Have Raised $1.7 Billion in 2021 – US Ambassador" *Naira Metrics* (20 December 2021) online: https://perma.cc/QX4S-B47H [statement by U.S. Ambassador to Nigeria, Mary Beth Leonard at the Nigeria Tech Summit: "Africa-based tech startups have raised more than $2.9 billion. Nigerian startups, which are creating new products, services, and platforms, raised $1.7 billion of this total or about 60% of it. Africa boasts a total of seven tech "unicorns," or companies valued at over $1 billion. I find it very exciting to note that three of these companies — Opay, Flutterwave, and Interswitch – are born and bred of Nigerian talent. We firmly believe that Nigeria, with the proper support, has enormous potential to do even more… The U.S. Mission will continue to do its part to support Nigeria's burgeoning tech scene and encourage the creation of enabling environment necessary to foster a sector that will, in turn, launch still more global businesses and contribute to a more prosperous future for all its citizens."].

DSTs on each other's tech start-ups. How might that impact the capacity of LIDC start-ups to innovate, expand, and, perhaps, compete with the more established businesses? It could mean, for instance, that Mdundo, a Kenya-based music streaming company that is often tagged the "Spotify of Africa",[764] but which has a much revenue catch and smaller market reach,[765] finds itself inundated with tax burdens from the countries where it operates. Needless to state that such a tax framework could limit the growth prospects of the enterprise.

It has been observed that one of the concerns with DSTs and other turnover-based withholding taxes is that they may be passed on to consumers or lead the business to exit the market.[766] Passing on has happened often in recent years.[767] The OECD foresaw these problems during its work on taxation of the digital economy and proposed then that withholding tax be used only as a collection tool for net-basis taxes.[768] As much as countries want to tax the income of non-residents, no country wants to see that tax passed on to consumers. This is because passing on DSTs, for instance, to consumers, not only eviscerates the purpose of an income tax, it may produce the same regressive effects as customs duties and excise taxes on internet use, which is to discourage users from accessing mobile services or encouraging them to explore back

[764] Namita Datta & Medha M Nair, "Why Policymakers Should Support Africa's Growing Music Industry", *World Bank Blog* (24 November 2021) online: https://perma.cc/SCP8-SZPJ.
[765] The company was operative in 15 sub-Saharan African countries as of 2020 and was in loss at the time. David Whitehouse, "Mdundo Music Platform Shareholders are Locked in to Losses", *The Africa Report* (17 September 2020) online: https://perma.cc/G8Q9-WWUA.
[766] Larking *supra* note 719 at 22.
[767] In response to DSTs imposed by European countries and India, companies like Apple, Amazon and Google hiked the cost of their services to clients in those countries. See Isobel Asher Hamilton, "Apple, Amazon, and Google hike their developer and ad client fees to pass on the costs of paying new digital taxes in Europe", *Business Insider* (2 September 2020) online: https://perma.cc/NGV3-EQMK; Silvia Amaro, "Big Tech Finds A Way to Pass on the Cost of Digital Taxes in Europe", *CNBC* (3 September 2020) online: https://perma.cc/C9F5-TWRF. Google makes it explicit that it is passing on DSTs as "Regulatory Operating Cost" to the users of its services. George Nguyen, "Google passes on 2% "Regulatory Operating Cost" for ads served in India and Italy", *Search Engine Land* (27 July 2021) online: https://perma.cc/CAZ2-NTU8.
[768] Larking *supra* note 719 at 22.

channels to avoid the charges.[769] Such a situation may ultimately inhibit internet connectivity and lower domestic tax revenue.[770] Accordingly, a strictly net-basis tax framework like Pillar One can help to sustain inclusivity in the digital economy.

When it comes to extolling the non-tax benefits of the Pillar One compromise, it seems the OECD has found it more convenient to speak in generic terms of supporting global investment and emphasizing the potential negatives of a no-deal situation, namely: a proliferation of uncoordinated and unilateral tax measures, an increase in damaging tax and trade disputes, both of which will undermine tax certainty and investment.[771] The two MNEs that have announced substantial and concrete investments in LIDCs since the deal was announced are Facebook and Google, all factors considered, it does not seem that the deal had any bearing on their respective decisions. Individual countries would have to evaluate for themselves whether the non-tax benefits that potentially accrue to them offset the revenue sacrifice that the deal requires. Such consideration should include the prospects of increased digital integration for their economies, the deal's capacity to shield their own digitalized businesses – especially start-up ventures – operating overseas from potentially inundating tax burdens and the likelihood that such shielding enables their domestic enterprises to innovate and thrive. As I stated in chapter 2, this is not intended to be a standalone factor, but rather a complementary factor that makes for a holistic account of reasonableness. My broader conclusions on the reasonableness of the Pillar One compromise are stated in paragraph 3.6. In the meantime, I make to address the political considerations surrounding it.

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[769] See Shamira Ahmed & Alison Gillwald, "Multifaceted Challenges of Digital Taxation in Africa" (2020) Research ICTA Africa Policy Brief No. 7.
[770] *Ibid.*
[771] OECD, *Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS* (Paris: OECD Publishing, 2020) at 11.

3.5 Political Landscape of the New Global Tax Deal

How is it that a multilateral tax deal that in some ways significantly impairs the tax jurisdiction of LIDCs – some more than others – has achieved such wide endorsement, by nearly 140 countries? How has such a "lopsided" deal been designed, in the first place, despite the overwhelming numerical participation of LIDCs? Pillar One is a highly political compromise.[772] Therefore, I think that a holistic appreciation of the compromise requires some extensive study of its political backdrop and the place of LIDCs in that process. This examination is the focus of this concluding section of the chapter. Here, I engage in an examination of the political aspects of the Pillar One compromise from three angles: inclusivity, sovereignty, and pluralism. But first, it is important to note that the new global tax deal is rooted in a chequered century old history of international tax multilateralism that is shrouded in participatory skepticism. Therefore, the ensuing perspectives on inclusivity, sovereignty, and pluralism, must be preceded by a critical exploration of the historical aspects of international tax compromise, i.e., the histo-political circumstances that produced the initial compromise and led to the present one.

3.5.3 Historical Dimensions

The regime governing the allocation of international tax rights is the outcome of a chain of international compromises that crystalized during the period right after the First World War (WW1) and the early 1970s.[773] The cardinal aim of this regime is the relief/elimination of

[772] Josh White, "The OECD's Digital Tax Plan More Costly than BEPS", *Int'l Tax Review* (6 June 2019) online: https://perma.cc/Z879-QX3K.

[773] The early historical development of the international tax regime is rich and well documented. This section only attempts a modest synopsis of that history, with greater effort dedicated to reviewing its political perspectives. For an elaborate documentation of this history, see Sol Picciotto, *International Business Taxation*, 2nd ed (Cambridge: Cambridge University Press, 2013) at 18–39; Sunita Jogarajan, *Double Taxation and the League of Nations* (Cambridge: Cambridge University Press, 2018).

international double taxation, while managing to balance that objective with tax competition and tax sovereignty.[774]

The emergence of double taxation as an impediment to international trade preceded WW1. Prior to that period, taxpayers had occasionally complained about the double tax burdens imposed on things like cross-border inheritance and governments provided some relief through domestic legislation and tax treaties.[775] The robust expansion of international trade and globalization shortly after WW1 inspired policymakers of the time to seek solutions to various barriers to international trade (including tax burdens) with the principal aim of facilitating trade between countries.[776] The war effort had driven participating states to increase their individual reliance on tax revenue, which consequently heightened the tax burdens of taxpayers, especially those involved in international trade.[777] The war period also witnessed a fundamental shift in the tax structure of states. Prior to that period, most states imposed easy-to-administer taxes on immobile economic assets and activities (e.g., real estate taxes and tariffs). However, the emergence of income taxes as the main source of tax revenue for most states increased the likelihood of international double taxation due to the relative cross-border mobility of the tax base.[778] The imperative to eliminate double taxation and facilitate international trade grew more pressing after WW1 as policymakers began to see trade liberalization as a mechanism to foster global peaceful coexistence.[779] The elimination of economic barriers would ameliorate conflict by spreading wealth and promoting interdependence

[774] Genschel & Rixen *supra* note 110 at 156.
[775] Edwin Seligman, *Double Taxation and International Fiscal Cooperation* (New York: Macmillan, 1928) at 37–57.
[776] Thomas Rixen, "Institutional Reform of Global Tax Governance: A Proposal" in P Dietsch & T Rixen, eds, *Global Tax Governance: What is Wrong with it and how to Fix it* (Colchester: ECPR Press) 325.
[777] Sven Steinmo, *Taxation and Democracy: Swedish, British and American Approaches to Financing the Modern State* (New Haven: Yale University Press, 1993) at 50–79.
[778] Seligman *supra* note 775 at 7–16.
[779] Mitchell B Carroll, *Prevention of International Double Taxation and Fiscal Evasion. Two Decades of Progress under the League of Nations* (Geneva: League of Nations, 1939).

thereby making war anathema to the economic interests of leading states.[780] Therefore, the substantial work done by the League of Nations, as well as the early tax treaty models, reflects a fundamental recognition that countries have a substantial interest, both for themselves and for their nationals, to avoid impediments to trading relationships and commercial activity occasioned by uncoordinated multiple taxation of the same income and the same taxpayers.[781]

In 1921, following persistent calls by the International Chamber of Commerce (ICC) for the reduction of international double taxation and the recommendation of the 1920 International Financial Conference at Brussels to that effect, the League of Nations, through its Financial Committee, commissioned "four economists" (Professors Bruins, Einaudi and Seligman, and Sir Joshua Stamp) to undertake a theoretical study of the issue of double taxation and to make recommendations on how states could solve the problem. The four economists published a formal report (1923 Report).[782] The report concludes that the doctrine of economic allegiance constitutes the most reasonable ground for a claim of tax jurisdiction and that the 'modern' tax system is based on ability to pay, a conclusion that is regarded as a nudge towards residence country taxation.[783] The report further explains double taxation as a consequence of double (or multiple) economic allegiance, and outlines four alternative approaches to double taxation relief.[784] Each solution requires states to give up taxing rights either at source or residence.[785] The fundamental question

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[780] Norman Angell, *The Great Illusion: A Study of the Relation of Military Power in Nations to their Economic and Social Advantage* (New York: G.P. Putnam & Sons, 1911).
[781] Lara Friedlander & Scott Wilkie, "Policy Forum: The History of Tax Treaty Provisions-And Why It Is Important To Know About It" (2006) 54:4 Can Tax J 907 at 909.
[782]1923 Report *supra* note 144.
[783] Picciotto *supra* note 773 at 19.
[784] *Ibid.*
[785] *Ibid* at 41–42. The four options presented are: (1) the deduction method, requiring the state of residence to allow deduction of all taxes paid at source; (2) the exemption method, requiring the source state to exempt the income of non-residents from taxation; (3) the division method, requiring the source and residence states to split the tax relief obligations; and (4) the apportionment of taxable items method, requiring the scheduling of income into different classes and assignment of taxing rights over some classes to the resident state and others to source state.

for negotiation – the subject of compromise – was, "which Governments should give up revenue, and to what extent?"[786] The authors of the report were cognizant of the priority of source tax jurisdiction and were keen to restrict it, out of concern over the potential of source taxation to deplete residence taxation. As the 1923 report notes: "[it] might be desirable to impose some limit upon the power of the country of origin to levy in [the] future specially heavy specific origin taxes which would unduly deplete the exchequer of the country of residence".[787]

The 1923 Report concludes, in alignment with its fourth option, that the right to tax different kinds of wealth should be partitioned between residence and source countries. All kinds of corporeal wealth, including immovables and tangible movable assets, should be taxed by the source country, while all intangible wealth, except mortgages, should be taxed principally or wholly by the country of residence.[788]

In 1922, prior to receiving the economists' report, the Financial Committee of the League of Nations also appointed a group of "Technical Experts", comprising government tax officials from seven European countries (Belgium, Czechoslovakia, France, Britain, Italy, The Netherlands and Switzerland), to study the technical and practical aspects of the double taxation problem. The resolutions of the Technical Experts, together with a general report, was submitted to the Financial Committee in 1925 (1925 Report).[789] The 1925 Report, which also drew from the theoretical work of the 1923 Report, introduced two clusters of tax: schedular taxes (taxes levied on activities or things) and general or personal taxes on income. For schedular taxes, the Technical Experts stressed the importance of source taxation, while they also recognized the importance of residence

[786] The 1923 Report *supra* note 144 at 40.
[787] *Ibid* at 42.
[788] *Ibid.*
[789] See, Financial Committee, *Double Taxation and Tax Evasion – Report and Resolutions Submitted by The Technical Experts to the Financial Committee of the League of Nations League of Nations* (Geneva: League of Nations, 1925).

country taxation for personal taxes. The 1925 Report is said to, overall, weigh in favour of residence taxation.[790] The report was submitted to the Financial Committee and became part of the material for a series of multilateral negotiations between national governments of the major industrialized countries, coordinated by the League of Nations.[791]

In 1927, an expanded Committee of Technical Experts, also commissioned by the League of Nations,[792] forged another report (the 1927 Report) which included a draft Model Convention containing key principles that would serve as the framework for negotiation of a treaty between states.[793] The draft Model Convention, contained in the 1927 Report, divided all direct taxes into personal and impersonal, but left it to the contracting states to decide which taxes to include in each class.[794] The draft Model Convention tilted towards source country taxation, with some concessions granted to the country of residence.[795] The country of source retained the right to levy impersonal taxes, as well as personal taxes on income from immovable property and from industrial, commercial and agricultural undertakings.[796] The country of residence, on the other hand, was restrained from levying impersonal taxes and was required to allow deductions from its personal tax of that portion of the income already taxed in the source country.[797]

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[790] Wang *supra* note 145 at 84.
[791] The initial participating countries were Argentina, Belgium, Czechoslovakia, France, Germany, Italy, Japan, the Netherlands, Poland, Switzerland, the United Kingdom, the United States, and Venezuela.
[792] Committee of Technical Experts on Double Taxation and Tax Evasion 1927.
[793] Financial Committee, *Report Presented by the Committee of Technical Experts on Double Taxation and Tax Evasion* (Geneva: League of Nations, 1927).
[794] Wang *supra* note _ at 84.
[795] *Ibid* at 86.
[796] *Ibid.*
[797] *Ibid.*

The draft convention contained in the 1927 Report was subsequently made into three draft bilateral conventions in 1928. These draft model conventions were submitted for consideration by a general meeting of governmental experts called by the League, in Geneva in October 1928.[798]

Although these draft conventions did not significantly differ in terms of the general principles upon which the jurisdiction to tax could be appropriated, as stipulated in the 1927 Report, the development of these draft conventions witnessed an increased prioritization of the principle of residence.[799] Residence was made the basis of tax jurisdiction for an extensive range of taxable items, including income from maritime shipping or air navigation, public loans, employment, royalties, annuities, and independent services. Where tax is levied by the state of source, the residence country would be required to provide relief by way of exemption or rebate.[800] The same increasing residence country bias can be ascribed to the subsequent draft plurilateral convention of 1931[801] and the 1933 draft bilateral convention (prepared mainly to deal with the problem of allocation) which reinforced the preference for residence country taxation with provisions that include a rather restrictive permanent establishment requirement for taxation of business profits at source.[802] The Technical Experts were, however, conscious of the fact that the pro-residence principle was unlikely to gain widespread acceptance because, even beside the validity of the economic arguments made in its favour, the imbalances of international investment flows were hard to sell to capital-importing countries.[803] The residence principle mostly benefited creditor/capital-exporting countries while the source principle was more appealing to

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[798] Picciotto *supra* note 773 at 20.
[799] Wang *supra* note 145 at 92–93.
[800] *Ibid.*
[801] Financial Committee, *Report to the Council on the Work of the Third Session of the Committee* (Geneva: League of Nations, 1931).
[802] Financial Committee, *Report to the Council on the Fourth Session of the Committee* (Geneva: League of Nations, I933), Article 1. See Wang *supra* note 145 at 94.
[803] Picciotto *supra* note 773 at 20.

debtor/capital-importing countries.[804] Debtor countries were mostly unwilling to give up jurisdiction to tax foreign investors, especially the profits made by businesses owned or financed from abroad.[805] This divisive factor obstructed the march towards a compromise involving large capital importers like France, Germany, and Italy and large capital exporters like the Netherlands, the United Kingdom, and the United States.[806] Indeed, due to the potential distributional disparity between residence and source countries, countries could not form consensus on a binding multilateral compromise and the initial intention to enter into a binding multilateral tax treaty was abandoned altogether.[807] The focus, thus, shifted towards the development of a bilateral treaty framework. The three 1928 variants on direct taxes were to serve as models for bilateral agreements.[808] The main purpose of bilateral treaties was to settle conflicting claims of tax

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[804] Ring, "International Tax Relations", *supra* note 2.

[805] Picciotto *supra* note 773 at 20.

[806] Graetz & O'Hear *supra* note 34. As Wang narrates, there were also significant difficulties concerning the apportionment of income when source was traceable to more than one state. There were different suggested approaches to solving this problem. One possible solution is contained in an addendum to the 1923 report, also submitted by the four economists, which suggested apportionment on the basis of the following considerations: 1. Value of sales; 2. Total capital involved in the business in each country; 3. Total stocks of goods maintained in each country; 4. Where property or real estate is involved, the total value in each country (this may be modified, where value is not appropriate, by total area, cubic space or other criteria for productive output); 5. Total salaries and establishment expenses; 6. Total credits arising in each country. Another subsequent suggestion by the Committee of Technical Experts, however, deviated from this suggestion in favour of an apportionment system whereby income from industrial, commercial, or agricultural ventures and from any other trades or professions shall be taxed only in a state where there is a permanent establishment; and in situation where there is a permanent establishment in more than one state, each state shall tax only the income produced in its territory. This format was incorporated into the subsequent 1928 Model Conventions. See Wang *supra* note 145 at 77–81; 1923 Report *supra* note 144 at 52.

[807] Picciotto *supra* note 773 at 23 & 47.

[808] Despite the lack of a general consensus, one major contribution of the three draft model conventions was the entrenchment of the permanent establishment concept, which became crucial to the bilateral compromise between residence and source countries. According to Picciotto: "[t]he concept of the Permanent Establishment was the key to the compromise between the economic interests of creditor and debtor countries, as well as for an accommodation between the business tax systems of a personal character based on income and those of a real character based on sources of revenue. It established a separation between the taxation of business profits which could be attributed to a Permanent Establishment and taxed at source, and the taxation of investment profits, which could be treated as `personal income and taxed in the country of residence of the investor. It also offered a basis for accommodation between debtor and creditor countries: foreign-ˇowned branches or subsidiaries could be taxed at source, provided this was limited to the business profits of a permanent establishment; while the home country could retain the right to tax its residents (including corporate groups) on their global income, although this should be subject to a credit or exemption for business profits taxed at source". Picciotto *ibid* at 24.

jurisdiction between states, while sovereign states retained the liberty to decide what taxes to impose.[809]

The model for "good tax behaviour"[810] in international taxation envisioned in the model tax treaties continued to evolve during and after the Second World War (WW2), even though only about 60 general tax treaties were signed between 1920 and 1939.[811] One of the important international developments following the end of WW2 was the scrapping of the League of Nations and its replacement by the United Nations. In the immediate aftermath of the war, attempts by the successor to the League of Nations' Financial Committee, the United Nations Committee of Experts on International Cooperation in Tax Matters (UN Tax Committee) to continue the mandate of shaping international tax policy were frustrated by a lack of consensus between capital exporting and capital importing countries over how tax treaties should fundamentally apportion taxing rights. Capital-exporting countries continued to favour greater emphasis on residence taxation vis-à-vis source taxation, while capital importing countries clamoured for the opposite.[812] Capitalizing on the deadlock at the UN level and the push by the influential ICC for a tax treaty framework that could be used by HIDCs, in 1954, the OECD Committee on Fiscal Affairs assumed the task of designing the framework for a model convention for agreement on double taxation between member countries.[813] The OECD published the OECD MTC in 1963 as a framework for the negotiation of bilateral tax treaties. The OECD MTC was developed in response to the needs of

809 Genschel & Rixen *supra* note 110 at 159.
810 Eden *supra* note 6 at 368.
811 Picciotto *supra* note 773 at 25.
812 See Kobetsky *supra* note 514 at 142–149 [discussing the collision between capital-importing countries and capital-exporting countries over two draft model treaties that were framed around the end of WW2: the Mexico Model of 1943 and the London Model of 1946. The latter would eventually prevail largely due to its preference by the great powers].
813 The OECD was formed in 1948 as Organisation for European Economic Cooperation (OEEC) to coordinate the Marshall Plan relief. It was in this status that the OEEC assumed the role of tax norm setter. The OEEC transformed into the OECD in 1961 with the significant addition of U.S. membership.

HIDCs to have a "firm and solid" treaty base to use in negotiations[814], but became the settled standard for tax treaties globally.[815] The Convention – largely a codification of the principles developed in the League of Nations era – embodies the primary framework for the compromise of tax jurisdiction between countries.[816] It represents "the closest existing analogy to a global (though partial) set of tax norms, and it widely influences the laws and treaties of OECD members as well as nonmember states".[817] The OECD MTC serves an important purpose of fostering common understanding of principles in actual tax treaties that adopt similar language and facilitates efficient negotiation of tax treaties by providing a baseline that allows parties to focus on points of potential disagreement.[818]

Beside designing the initial – and lasting – framework for international taxing rights allocation, the OECD has reigned supreme as the principal institution that designs models for all forms of international tax policy, leading some to regard the OECD as a *de facto* world tax body.[819] This may be so because "the Committee on Fiscal Affairs (of the OECD) has managed to settle on standards that are neither hopelessly utopian, nor merely an endorsement of the status quo."[820] But, it may also be so because of the sheer political influence that the OECD can muster.

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[814] Donald R Whittaker, "An Examination of the O.E.C.D. and U.N. Model Tax Treaties: History, Provisions and Application to U.S. Foreign Policy" (2016) 8:1/4 NC J Int'l L & Comm Reg 39 at 44.

[815] The principles of double taxation relief incorporated in the OECD MTC are also widely incorporated into the domestic tax legislation of countries. Thus, entities operating transnationally also enjoy double tax relief from countries that are not treaty partners with their countries of residence. As Genschel & Rixen observe, even though the OECD MTC was not initially intended to operate at national level, its principles now serve as a reference point for national laws on tax relief. Most national laws follow the principles and structure of double tax relief contemplated in the OECD MTC, including the structure of taxing active and passive income. Genschel & Rixen *supra* note 110 at 162.

[816] A synopsis of some important provisions of the OECD MTC is provided in the chapter 2 (subsection 2.3.2.1).

[817] Yariv Brauner, "An International Tax Regime in Crystallization" (2003) 56 Tax L Rev 259 at 261.

[818] Patricia Brown *supra* note 305 at 399–400.

[819] See Arthur J Cockfield, "The Rise of the OECD as Informal 'World Tax Organization' through National Responses to E-Commerce Tax Challenges" (2006) 8 Yale J L & Tech 136; Hugh J Ault, "Some Reflections on the OECD and the Sources of International Tax Principles" (2013) Tax Notes Int'l 1195; Aleksandra Tychmanska, "The OECD as the Future International Tax Organization: An Inevitable Course of Events?" (2021) 49:8/9 Intertax 614.

[820] Sharman *supra* note 239 at 21

Kiser & Karceski observe that "most important political outcomes are the joint product of structural conditions".[821] The rules governing international allocation of taxing rights – with their distributional effects – are outcomes that cannot be divorced from their formative political landscape. I have highlighted in this section how positions taken by certain countries – or groups of countries – and, in some instances, a non-state actor: the ICC, shaped the developmental trajectory of the double taxation compromise, including the displacement of the League of Nations (effectively the UN) by the OECD as the principal forum for global tax policy development. International tax regimes are generally products of negotiated compromise, and as with anything that requires compromise or consensus amongst actors with divergent interests, there is scope for political dealing, sometimes between those that do not deal from positions of equal economic or political strength.[822] There can, therefore, be no pretence that international tax rules are sewn from linens of technical purity and political neutrality.[823]

Scholars have increasingly paid attention to the instrumentality of (economic and political) power in shaping taxing rights allocation compromises and, consequently, the distribution of global tax revenue.[824] It is a part of the sentiment in critical international tax scholarship that LIDCs are

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[821] Edgar Kiser & Steven M Karceski, "Political Economy of Taxation" (2017) 20 Ann Rev Pol Sc 75 at 76.
[822] It has been suggested that the relative material resources of states often determine the outcomes of international bargains. States with more resources can ensure convergence of other states on their preferred outcomes by leveraging on their relative economic power to issue threats as well as inducements, where preferable. See Jeffrey W Legro & Andrew Moravcsik, "Is Anybody Still a Realist?" (1999) 24:2 Int'l Sec 5.
[823] Emblad *supra* note 15 at 18 ["When analyzing the development of the international tax order from a power perspective, however, it does become clear that this order is neither neutral nor equal. The international efforts to prevent double taxation in the early 20th century manifested themselves in a policy framework that favored economically stronger states. The efforts to prevent double non-taxation in the 21st century is not a correction of these inequalities, but rather a restoration of them".].
[824] Brooks & Krever *supra* note 17; Oguttu *supra* note 698; Irene Burgers & Irma Mosquera Valderrama, "Corporate Taxation and BEPS: A Fair Slice for Developing Countries?" (2017) Erasmus L Rev 29 at 33; Christians & Magelhães *supra* note 43; Vet, Cassimon de Vijver *supra* note 19; Magalhães *supra* note 246; Hearson "Imposing Standards" *supra* note 21; Rasmus Corlin Christensen & Martin Hearson, "The New Politics of Global Tax Governance: Taking Stock a Decade After the Financial Crisis" (2019) 26:5 Rev Int'l Pol Econ 1068; Manuel F Montes Danish & Anna Bernardo, eds, *International Tax Cooperation: Perspectives from the Global South,* xiv, (2019); Rasmus Corlin Christensen, Martin Hearson & Tovony Randriamanalina, "At the Table, Off the Menu? Assessing the Participation of Lower-Income Countries in Global Tax Negotiations" (ICTD Working Paper 115, 2020); Emblad *supra* note 15.

trapped in an international tax regime that is framed by dominant HIDCs in a way that leaves them (LIDCs) with little choice than to accept "unfair" bargains over tax sovereignty and tax jurisdiction.[825] The uneven power complex of the international tax regime is systematically reflected in its distributional imbalance, which disproportionately favours residence countries – i.e., the countries where the headquarters of TNCs are located – over source countries, where key economic activities take place.[826] It also reflects in the persistence with standards of profit allocation rules that are innately too complex for LIDCs to administer and which, consequently, robs LIDCs of tax revenue, often in favor of HIDCs where benefitting taxpayers reside and repatriate tax revenue.[827]

It seems an indisputable reality of international relations that states are not and have never been equal, and the international tax regime was birthed – and is maintained – in that state of structural inequality.[828] It is no surprise that barely a decade after the OECD MTC came into being, tax scholars had begun to spotlight the power imbalances dictating the entrenchment of a pro-residence tax regime. Charles Irish noted these imbalances in the following words:

> There appear to be several reasons for the emphasis on residence in tax agreements between developed countries. Probably the fundamental reason is that the emphasis on residence represents the more favorable alternative for the country with the stronger bargaining position. Frequently countries have an interest in capital, technology and services possessed by the taxpayers of other countries. In such instances, the 'interested' country is the potential source country and the other is the potential residence country. As between

[825] See Tarcísio Diniz Magalhães, "International Tax Law Between Loyalty, Exit, and Voice" (2021) 44:1 Dalhousie LJ 49. Critical theory "endeavors to challenge and change society". This contrasts with "traditional theory" which merely seeks to understand and explain society. See Emblad *supra* note 15 at 3.

[826] Magalhães *supra* note _.

[827] Vet, Cassimon, & de Vijver *supra* note 19 [arguing that the transfer pricing methodology favored by HIDCs fail to adequately account for the contributions of LIDCs and reinforce the existing distributional imbalances in the international tax regime]. It is worth reiterating that administrability is an important component of tax jurisdiction. Therefore, administrative rules that are unenforceable have the potential to eclipse the capacity of countries to exercise their tax jurisdiction.

[828] See Karl Loewenstein, "Sovereignty and International Co-operation" (1954) The Am J Int'l L 222 at 223 ["the assumptions of both equality and the independence of states are fictions. States never have been, nor are they now, equal. They differ widely in their power potential and, consequently, also in the degree of their independence"].

> the two countries, the potential residence country thus has the stronger economic position and the evidence indicates that it has used its superior position to 'persuade' the source country to forgo tax revenues so as to insure availability of the desired capital, technology and services. This apparently is what happened immediately after World War II between the countries of Western Europe and the United States. At that time, the Western European countries were very interested in attracting United States capital and technology to rebuild and modernize their war-ravaged economies. In order to ensure the unfettered flow of such capital and technology into their economies, these countries accepted tax agreements with the United States with a heavy emphasis on the residence principle.[829]

International taxation deals with two main policy issues: international double taxation and international tax competition.[830] Yet the approach of the international tax regime towards addressing these issues has often reflected the class parochialism that undermines system inclusivity and legitimacy. First, with regard to containing international tax competition, or what the OECD labels "harmful tax competition",[831] rich (OECD) countries have often gone to lengths to name and shame small country tax havens and to use coercive force on such countries to adjust their tax systems to conform with required standards of transparency and anti-abuse[832] while simultaneously meting out a milder treatment to their own members who are reported to be the biggest facilitators of "harmful tax competition".[833] Some commentators view this "selective"

[829] Charles R Irish, "International Double Taxation Agreements and Income Taxation at Source" (1974) 23:2 Int'l & Comp L Qtly 292 at 294.
[830] Genschel & Rixen *supra* note 110 at 154.
[831] Joann M Weiner & Hugh J Ault, "The OECD's Report on Harmful Tax Competition" (1998) 51:3 Nat Tax J 601.
[832] See, for instance, Irma Johanna Mosquera Valderrama, "The EU Standard of Good Governance in Tax Matters for Third (Non-EU) Countries" (2019) 47:5 Intertax 454 [discussing how in 2008 the EU Economic and Financial Affairs Council (ECOFIN) introduced the standard of good governance in tax matters with a view to tackling tax fraud and tax evasion. The EU subsequently imposed this standard as a precondition for third (non-EU) countries to receive development aid, conclude strategic partnership agreements, free trade and economic partnership agreements and more recently as a standard that determines whether the third (non- EU) country should be included in a single EU common list of non-cooperative jurisdictions]. See Lukas Hakelberg, "Coercion in International Tax Cooperation: Identifying the Prerequisites for Sanction Threats by a Great Power" (2016) 23:3 Rev Int'l Pol Econ 511 at 513 [examining the merits of great power coercion as a necessity for ensuring international tax cooperation against tax abuse, noting: "Redistributive cooperation in tax matters results from a credible threat of economic sanctions by a great power. Great powers are defined by large internal markets, which make them less dependent on international trade and investment than small countries. By conditioning access to their markets on compliance with their preferred rules, they can thus wrestle costly concessions from small country governments"].
[833] Steven A Dean, "FATCA, the U.S. Congressional Black Caucus, And the OECD Blacklist" (2020) 99 Tax Notes Int'l 83 at 89 ["The OECD's 2000 list — referred to universally, if not officially, as a blacklist — had at least one striking omission. To some, the United States itself deserved to be included. But looking back on the OECD effort, it

assertion of coercive force as a micro reflection of the broader power distribution problem that confronts international tax relations.[834]

On the classic politics of double taxation prevention, two important historical events elucidate the stranglehold that HIDCs have on the basic structure of international taxing rights allocation. First, during WW2 and the preoccupation of the world's major powers with that armed conflict, LIDCs from mostly the Latin American region, at the Fiscal Committee Conference of 1940, masterminded an attempt to replace of the League of Nations' 1928 Model Convention with the draft 1943 Mexico Model.[835] The Mexico draft was designed to promote the use of tax treaties between HIDCs and LIDCs and was generally more consistent with the principle of taxing income at source.[836] However, upon their post-war return, HIDCs widely rejected this more pro-source taxation arrangement; and, instantly, replaced it with the draft 1946 London Model. The London draft reverted to the pro-residence country bias that preceded the Mexico Model.[837] It is no surprise that Latin American countries for a long time resisted the urge to sign tax treaties.[838] According to

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is hard to dispute that Switzerland, a member of the OECD, should have been included"]; Lukas Hakelberg & Max Schaub, "The Redistributive Impact of Hypocrisy in International Taxation" (2017) 12:3 Reg & Gov 353 [highlighting US hypocrisy and redistributive unfairness in its so-called fight against tax havens]; Alex Cobham & Javier Garcia-Bernardo, "Time for the EU to Close its Own Tax Havens", *Tax Justice Network* (4 April 2020) online: https://taxjustice.net/wp-content/uploads/2020/04/Time-for-the-EU-to-close-its-own-tax-havens_April-2020_Tax-Justice-Network.pdf; Steven A Dean & Attiya Waris, "Ten Truths About Tax Havens: Inclusion and the Liberia Problem" (2021) 70:7 Emory LJ 1657; Mark Bou Mansour, "Tax Haven Ranking Shows Countries Setting Global Tax Rules Do Most To Help Firms Bend Them", *Tax Justice Network* (9 March 2021) online: https://taxjustice.net/press/tax-haven-ranking-shows-countries-setting-global-tax-rules-do-most-to-help-firms-bend-them/.

[834] See Dean *ibid;* Hakelberg *ibid.* Hakelberg, however, examines how the European Union, following United States' example, has used coercion to cause its "deviant" members to comply with international tax transparency regimes. See Lukas Hakelberg, "The Power Politics of International Tax Co-operation: Luxembourg, Austria and the Automatic Exchange of Information" (2015) 22:3 J EU Pub Pol'y 409.

[835] Whittaker *supra* note 814 at 43.

[836] *Ibid.*

[837] See Doron Narotzki, "Tax Treaty Models – Past, Present, and a Suggested Future" (2017) 50 Akron LJ 383 at 385; Brooks & Krever *supra* note 17 at 163.

[838] Lee A Sheppard, "How Can Vulnerable Countries Cope with Tax Avoidance?" (2013) 69 Tax Notes Int'l 410 ["Smaller, capital-importing, mineral-exporting, or market countries should never sign OECD model bilateral double tax treaties. South American countries do not sign them".].

Carroll, Latin American countries overwhelmingly favored source country taxation over residence country taxation. Thus, these countries considered the European definition of a permanent establishment too restrictive and unfit for the purpose of source country taxation.[839]

Second, around the 1970s, the emergence of tax scholarship that critically appraised the distributional orientation of taxing rights allocation based on the OECD MTC led to a few amelioratory developments. First, a Group of Experts of the Latin American Free Trade Association (LAFTA) published an alternative Model Convention (1976) that was more favorable to source-based taxation vis-à-vis the OECD MTC and was meant for use between LAFTA member states and states outside the region. The LAFTA Model Convention descended into oblivion because OECD countries declined to sign tax treaties based on it.[840] The demise of the LAFTA Model Convention was shortly after succeeded by a response from the UN Tax Committee, which released the UNMTC in 1980.[841] The UNMTC is designed to be more favourable to LIDCs by limiting the restrictions on source taxation.[842] However, the UNMTC is also a mere variation of the OECD MTC; and a major reason for its limited departure from the OECD version is the insistence of HIDCs.[843] Otherwise, it is predictable that the UNMTC would have followed a similar path to oblivion as the LAFTA model.

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[839] Carroll, "International Tax Law" *supra* note 252 at 708.
[840] Genschel & Rixen *supra* note 110 at 161 & 163.
[841] UNMTC *supra* note_.
[842] Like the OECD MTC, the UNMTC has had several iterations – the latest being in 2021 – and continues to be improved towards better source taxation by LIDCs. In a world where the proliferation of tax treaties seems inevitable, the place of such a model, if afforded broad embracement, is invaluable for the DRM objectives of LIDCs.
[843] Sergio Rocha, "International Fiscal Imperialism and the 'Principle' of the Permanent Establishment" (2014) 64 Bull Int'l Tax'n 83 at 84 ("As the position of the developed countries prevailed [on the development of the UN Model], the UN Model ended up very similar to the OECD Model and failed to achieve its objective of fairly distributing taxing rights between developed and developing countries."). For a more positive take, see, Ring, "International Tax Relations", *supra* note _ at 145 ["The OECD Model Treaty had become such an established benchmark that unnecessary departures from its structure and content would have made the U.N. Model Treaty less attractive and less susceptible to adoption"].

Ironically, decolonization and the consequent emergence of many non-Western LIDCs as new frontiers of capital export for western HIDCs became a driving factor in the convergence of HIDCs around the OECD MTC principles which HIDCs had previously found difficult to reach common ground on. These newly independent, capital-importing countries allowed HIDCs viable alternatives to export capital to and derive huge revenue under the subsisting pro-residence country framework. As Genschel & Rixen explain:

> With respect to non-Western states, all Western states were capital exporters. This facilitated their eventual convergence on the OECD Convention's heavily residence-based rules for taxing cross-border (passive) income flows. Second, power asymmetry: The Western countries dominated the world economy. They were the main global suppliers of real, financial, and human capital. The rest of the world depended on Western investment more than the West in turn depended on investment from the rest of the world. This gave Western governments extensive power to dictate the terms under which cross-border flows of investment income are taxed.[844]

The above spectrum of reality has led some scholars to excoriate the international tax regime as an exclusionary, hegemonistic, imperialistic, and exploitative manifestation of global tax order which systematically suppresses and deprioritizes the voices and interests of LIDCs, to the advantage of HIDCs or their transnational corporations[845], while other commentators highlight

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[844] Genschel & Rixen *supra* note 110 at 162.

[845] See Dagan *supra* note 283; Magalhães *supra* note _. The rise of critical theoretical – and reconstructive – perspectives, especially from the Global South, vastly contributes to the advancement of a more robust and inclusive academic engagement on global politics in all areas of international law, including international fiscal law. The philosophical underpinnings of these perspectives are rooted in what is termed "Third World Approaches to International Law" (TWAIL). Classic TWAIL sentiment is captured in the piercing words of the Kenyan-American legal scholar, Makau Mutua: "The regime of international law is illegitimate. It is a predatory system that legitimizes, reproduces and sustains the plunder and subordination of the Third World by the West. Neither universality nor its promise of global order and stability make international law a just, equitable, and legitimate code of Global governance for the Third World. The constriction and universalization of international law were essential to the imperial expansion that subordinated non-European peoples and societies to European conquest and domination". See Makau Mutua, "What is TWAIL?" (2000) 94 Proceedings of the Annual Meeting – Am Soc Int'l L 31. For more constructivist approaches, see also Obiorah C Okafor, "Critical Third World Approaches to International Law (TWAIL): Theory, Methodology, or Both?" (2008) 10:4 Int'l Comm L Rev 371; Ibironke Tinuola Odumosu, "ICSID, Third World Peoples and the Re-Construction of the Investment Dispute Settlement System" (PhD Thesis, University of British Columbia, 2010); James T Gathii, "TWAIL: A Brief History of Its Origins, Its Decentralized Network, and a Tentative Bibliography" (2011) 3:1 Trade L & Dev 26; SG Sreejith, "An Auto-Critique of TWAIL's Historical Fallacy: Sketching an Alternative Manifesto" (2017) Third World Qtly 1511. Scholars' (express or implicit) leanings on

and, in some cases, question the incursion of the international tax regime on the tax sovereignty of LIDCs.[846] Tsilly Dagan, for instance, contends that tax treaties "serve much less heroic goals, such as easing bureaucratic hassles and coordinating tax terms between the contracting countries, and much more cynical goals, particularly redistributing tax revenues from the poorer to the richer signatory countries."[847]

Oladiji is convinced that "international law - especially as it relates to taxation - has been utilised by some dominant western states to perpetuate their interests at the expense of other countries categorised as developing or less developed."[848] Accordingly, "although inclusiveness is said to lie at the heart of legitimacy and effectiveness, the voices of developing countries have been largely excluded from the formulation of global tax regulations."[849]

Similarly, for Rocha, the international tax regime is a theatre of imperialistic and exploitative power which is exemplified by "the transformation of certain tax criteria that favor the interest of developed economies into international tax standards that become considered as basic principles of international taxation".[850] These international tax standards, according to Magalhães, are

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TWAIL thought to confront international economic law issues can enrich the conversation on how economic-political power dynamics and political brokerage shape the outcome of international tax compromises, with particular emphasis on the current international tax regime. For a characterization of international tax as international law see, for instance, Avi-Yonah *supra* note 2 at 1.

[846] Vaughn E James, "Twenty-First Century Pirates of the Caribbean: How the Organization for Economic Cooperation and Development Robbed Fourteen Caricom Countries of their Tax and Economic Policy Sovereignty" (2002) 34 U Miami Inter-Am L Rev 1 at 30; Steve Dean, "Philosopher Kings and International Tax" (2007) 58 Hastings LJ 911; Diane M Ring, "What's at Stake in the Sovereignty Debate: International Tax and the Nation-State" (2008) 49:1 Va J Intl L 155 at 156 ["No significant issue in international tax can be discussed without raising the question of sovereignty. Does a particular outcome or position harm or infringe upon a nation's sovereignty? Is sovereignty advanced by the proposed tax plan? Should a sovereign nation participate in multilateral tax cooperation to solve shared problems?"].

[847] Dagan, "The Tax Treaties Myth" *supra* note 283 at 939.

[848] Abosede Oladiji, "Global Tax Regulation and Developing Countries" (LLM Thesis, University of Manitoba, 2018).

[849] *Ibid.* Oladiji's thoughts mirrors the view expressed by Thomas Pogge that "[t]he affluent countries have been using their power to shape the rules of the world economy according to their own interests and thereby have deprived the poorest populations of a fair share of global economic growth". Thomas Pogge, "Eradicating Systemic Poverty: Brief for a Global Resources Dividend" (2001) 2:1 J Human Dev 59 at 63.

[850] Sergio A Rocha, "The Other Side of BEPS: "Imperial Taxation" and "International Tax Imperialism" in SA Rocha & A Christians, eds, *Tax Sovereignty in the BEPS Era* (Alphen aan den Rijn: Wolters Kluwer, 2017) 179 at 188.

perennially determined by small, non-inclusive, clubs of experts, scientific committees and working groups.[851] The author particularly takes issue with the role of the highly influential OECD – the so-called "rich countries club"[852] – which strings global reaching tax policies despite only representing the interests of a fraction of the world's countries.[853] The emergence of the OECD as, effectively, a world tax organization, despite its very limited membership and participation, heralded "the creation of an exclusionary architecture that deprives the majority of the world's countries from meaningfully influencing legal-institutional choices vis-à-vis what countries should tax cross-border transactions, a process that has clear global distributional implications."[854] It is important to expose this structural exclusivism because "in its regulatory solutions, the OECD tends to favor the interests of its rich country members and marginalize the concerns of poor countries."[855]

Because OECD countries, especially those in the G7, enjoyed a near-monopoly on the export of capital, the OECD could virtually monopolize work on the rules of taxing rights allocation without undermining global acceptance and effectiveness of those rules. If non-OECD countries refused to play along, they could be effectively ostracized from the international tax regime, and any

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[851] These groups include the League of Nations Fiscal Committee and Committee of Technical Experts, and the OECD Committee on Fiscal Affairs. See Magalhães *supra* note __.

[852] The OECD comprises 38 member states, most of which are regarded as developed countries. The OECD is frequently, derisively and, perhaps, resentfully, described as a "rich countries club" or a "rich man's club" in the academic literature. See Steve Dowrick & Duc-Tho Nguyen, "OECD Comparative Economic Growth 1950-85: Catch-Up and Convergence" (1989) 79:5 The Am Econ Rev 1010 at 1020; Reuven S Avi-Yonah, "Tax, Trade, and Harmful Tax Competition": Reflections on the FSC Controversy (2000) 21 Tax Notes Int'l 2841 at 2844; Richard Woodard, *The Organisation for Economic Co-operation and Development (OECD)* (New York: Routledge, 2009) at 1; Judith Clifton & Daniel Diaz-Fuentes, "From 'Club of the Rich' to 'Globalization A la Carte': Evaluating Reform at the OECD" (2011) 2:3 Global Pol'y 300; Sharman *supra* note 239 at 22; Otaviano Canuto & Tiago Ribeiro dos Santos, "What Can Brazil Expect from Joining the OECD?" (2021) 25 RTM 51 at 52. The OECD sometimes shares that appellation with other exclusive intergovernmental groups like the G7 and the G20. See Andrew F Cooper, "The G20 as an Improvised Crisis Committee and/or a Contested 'Steering Committee' for the World" (2010) 86:3 Int'l Affairs 741. Both "clubs" have also become significant powerbrokers in the international tax scene. Elaboration on this point in chapter 3.

[853] Magalhães *supra* note 246.

[854] *Ibid* at 499.

[855] Sharman *supra* note 239 at 24.

radically different alternative framework embraced by them could be rendered utterly redundant as was the case with the LAFTA Convention.[856]

The OECD is adjudged to perpetuate inefficient, inequitable, and obsolete elements of the international tax regime such as the permanent establishment and the separate entity/arm's length principles, allowing only piecemeal changes to international tax norms.[857] The OECD has, regardless, managed to maintain a monopoly as the forum for international tax reform, despite persistent calls for the establishment of a more representative world tax body.[858]

The establishment of such a body featured prominently in academic and public discourse in the period of transition to the 21st Century,[859] which culminated in the UN floating the idea at the Monterrey summit of 2002 as part of its International Financing for Development (FfD) initiative.[860] The UN's effort to make taxation a part of the conference agenda and to table the idea of an international tax organization was, however, frustrated because the rich countries showed little appetite to build such a body "while the OECD was already engaged in a comprehensive tax

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[856] Genschel & Rixen *supra* note 110 at 163.

[857] Magalhães *supra* note 246. See Fritz Brugger & Rebecca Engbresten, "Defenders of the Status Quo: Making Sense of the international Discourse on Transfer Pricing Methodologies" (2020) Rev Int'l Pol Econ 1 [discussing how an epistemic community of tax negotiators and tax professionals mainly residing in HIDCs and working through the OECD has maintained a half-century monopoly of settling global transfer pricing rules, namely the "OECD Transfer Pricing Guidelines". This community maintains the status quo by reinforcing the notion of indispensability of the OECD guidelines despite the existence of "alternative and potentially simpler" methods of MNE profit attribution].

[858] Magalhães *supra* note 246.

[859] See Vito Tanzi, "Does the World Need a World Tax Organization?" in A Razim & E Sadka, eds, *The Economics of Globalization: Policy Perspectives from Public Economics* (Cambridge: Cambridge University Press, 1999) 173; Vito Tanzi, "Globalization, Technological Developments, and the Work of Fiscal Termites" (2001) 26:4 Brook J Int'l L 1261 at 1281 [expressing skepticism about the possibility of the idea]; Frances M Horner, "Do We Need an International Tax Organization?" (2001) 24 Tax Notes Int'l 179 ["In fact, a new global institution in taxation policy will make a significant, non-redundant contribution to global governance if — and only if — it gives a full and true voice to the fiscal concerns and needs of developing countries"].

[860] Jorge Garcia-Arias, "The Systemic Approach to International Financing for Development and the Need for a World Tax and Financial Organization" (2013) 25:1 The European J Dev Res 60.

agenda".[861] The OECD lobbied the G7 to truncate the idea[862] and then followed up with the launch of the merely deliberative International Tax Dialogue, a forum comprising the OECD, World Bank, IMF and a few other organizations for voluntary exchange of ideas.[863]

The prolonged failure – or reluctance – of OECD member states, to address pertinent issues of international tax reform, especially issues of base erosion and profit shifting, that were of utmost concern to LIDCs, until a time of pressing strategic need for HIDCs further evidences the monopolistic and, perhaps, detrimental control that HIDCs enjoy over international tax governance.[864]

Certainly, not all international tax scholarship subscribes to the view that political influence has held much sway in the formation or sustenance of the international tax regime. Thus, a less deprecatory perspective on the subject is shared by scholars who opine that national interest, rather than political influence, ultimately defines the limits on tax jurisdiction that countries are willing to concede.

Diane Ring, for instance, conducts an extensive evaluation of the power subject in international tax regime formation. She draws on conventional perspectives of international relations theory to explain the structure of international tax regimes, specifically the double taxation regime. In

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[861] Dries Lesage & Thijs Van de Graaf, "Thriving in Complexity: The OECD System's Role in Energy and Taxation" (2013) 19:1 Global Governance 83 at 88.
[862] Vito Tanzi, *Globalisation and Coordination of Fiscal Policies*, 11 (University of Trento, Working Paper 03/2004, 2004) cited in Magalhães *supra* note 246 at 514.
[863] The UN was invited but did not join. Garcia-Arias *supra* note 860 at 88.
[864] See Richard Eccleston, *The Dynamics of Global Economic Governance: The Financial Crisis, the OECD and the Politics of International Tax Cooperation* (Cheltenham: Edward Elgar Pub, 2013); Christensen & Hearson *supra* note _. See also Genschel & Rixen *supra* note 110 at 169 ["the TLO's inbuilt distributive bias continues to benefit major OECD member states. Although these states may be suffering from tax competition with tax havens, they benefit from the Model Convention's residence-based rules on passive income in relation to non–tax haven states. Because most states continue to be non-havens, and because many of these non-havens heavily import Western capital and technical know-how, Western states have a vested interest in preserving the TLO".].

her article entitled "International Tax Relations: Theory and Implications",[865] the author asks some pertinent questions regarding how the double taxation regime – which consists of domestic rules and tax treaties – allocates taxing rights between states: "if (business) transactions cross national borders, who taxes them? What rules apply? And perhaps most important, what happens when countries disagree? Who 'prevails' and why?".[866] The last question is particularly important because, just as the author notes: "[i]f the goal is to understand and predict how nations reach agreement, then a willingness to examine a "national" perspective on negotiations is necessary."[867]

Ring observes that the basic goals, other than revenue, of the international tax regime are the same ones generally espoused for domestic tax policy: efficiency, equity and administrability; and achievement of any of these goals would usually require cooperation or agreement with other sovereign countries.[868] Cooperation is necessary because enactment of domestic legislation is often inadequate to achieve the intended tax policy. The tax rules and decisions of other jurisdictions are crucial to the bottom line for taxpayers with cross border income and for countries seeking to tax them. Thus, to effectively implement a desired tax policy it may be necessary to persuade other countries to participate in a shared vision, at least to some degree.[869] The author, thus, primarily views a mutual interest foundation as the building of an international tax regime.

Under what conditions are countries likely to agree? In responding to this question, the article turns to international relations theory and analysis.[870] A subset of international relations theory

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[865] Ring, "International Tax Relations" *supra* note 2.
[866] *Ibid.*
[867] *Ibid* at 88.
[868] *Ibid* at 87–89.
[869] *Ibid.*
[870] *Ibid* at 90.

– "international regime theory" – deals with how international regimes are formed.[871] Ring identifies four evaluative perspectives of international relations theory analysis – neorealism, neoliberalism, pluralism, and cognitivism – noting that that these perspectives form part of the background for the formation of international regimes.[872] The author infers that each of these major threads relies on a primary explanatory variable for behaviour and outcomes in the international context.[873] Neorealists view power as the driving force behind states' decisions, behaviour, and interactions on the world stage.[874] Central to a state's engagement on the world stage is its desire to achieve relative gains over other states; and the state, being a rational actor, will exert its (economic and political) power to achieve preferred ends, regardless of the distributional consequences for other states.[875]

According to Ring, neoliberalists regard states' self-interest, more than their power and craving for relative gain, as the primary driver of states' engagement on the international stage. They view a state's pursuit of national self-interest within a market-oriented ecosystem as a dominant factor in shaping international relations and in determining how successful international institutions can be in directing and modifying international behaviors.[876] Here, the pursuit of absolute gains (that is, both states are better off) is more important than the pursuit of relative gains (measured in comparison to other states' success).[877]

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[871] *Ibid* at 93–94 ["International regime theory ("regime theory") is that part of the international relations literature that seeks to answer the question of how and when countries reach agreement or how they cooperate"].
[872] Both neorealism and neoliberalism view the state as the primary actor on the international stage. Cognitivism and pluralists, as critical perspectives, place greater emphasis on the importance of knowledge/ideology and non-state actors respectively as drivers of compromise or regime formation on the international stage.
[873] *Ibid* at 93.
[874] *Ibid.*
[875] *Ibid* at 91
[876] States intervene to address global "market failures" (such as double taxation) as a way to preserve their self-interest. Ring states that market failure entails "a situation in which states may not reach their optimal outcome, an agreement, because of problems in the market structure (for example, information or monitoring"). *Ibid* at 105.
[877] *Ibid* at 93.

The cognitivists – critics of the neorealism and neoliberalism – treat knowledge and information as critical to the shaping of international regimes. Whomever has information, knowledge, and ideas, and whomever determines what we value and think, de facto determines much of the outcome.[878] This is because states create their identities and determine their interests based on the predominant beliefs held by state actors. Therefore, changes in knowledge and belief systems can trigger changes in policy. We should, therefore, focus attention on how knowledge is distributed and how it shapes the views of decision makers.[879]

Ring also highlights the emergence of "pluralism", a gap-filler framework which illuminates and analyzes the role of non-state actors such as individuals, bureaucracies, and nongovernmental organizations (NGOs) in decision making on the global level.[880]

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[878] *Ibid* at 93.

[879] *Ibid* at 92–93 & 112 ["Epistemic communities facilitate regime formation by first developing some consensus among themselves on an issue (for example, ozone). Second, the epistemic community, which exists across the relevant states, exerts influence to shape, direct, and change state views on the issue. This new knowledge and learning can cause the states to redefine their conception of their national interest. To the extent the epistemic community has been successful disseminating its information and causing decisionmakers to adopt its views, the "widely shared ideas may facilitate cooperation in the absence of a unique equilibrium, [and serve] as focal points which help define acceptable solutions to collective action problems"] referencing Peter M Haas, "Epistemic Communities and the Dynamics of International Environmental Co-Operation" (1992) 46:1 Int'l Org 1.

[880] *Ibid* 92. Although Ring does not pursue this perspective in her analysis of the double taxation regime, the initial reference illuminates the salient point that states are not the only (major) players in international regime formation. In a separate piece, Ring extensively explores the structure, *modus operandi,* and role of various transnational organizations – comprising both state and non-state actor bodies and interest groups – in shaping the norms of international taxation, including the so-called "soft norms". The organizations surveyed include: Centre de Rencontre et d'Etudes des Dirigeants des Administrations Fiscales (CREDAF), Commonwealth Association of Tax Administrations (CATA), Inter-American Centre for Tax Administrations, International Tax and Investment Organisation (ITIO), Intra-European Organisation of Tax Administrations (IOTA), Leeds Castle Group, Organisation for Economic Cooperation and Development (OECD), Pacific Association of Tax Administrators (PATA), Seven Country Working Group, United Nations (U.N.) (organizations with state membership) and Business and Industry Advisory Committee (BIAC) Center for Freedom and Prosperity (CFP) Confederation Fiscale Europeenne (CFE) European American Tax Institute (EATI) European Association of Tax Law Professors (EATLP) European Taxpayers Association Institute for Fiscal Studies (IFS), Institute for Professionals in Taxation (IPT), International Bureau of Fiscal Documentation (IBFD), International Chamber of Commerce (ICC), International Federation of Accountants (IFAC), International Fiscal Association, International Tax Dialogue (ITD), International Tax Planning Association (ITPA), Tax Executive Institution (TEI), United States Council for International Business (USCIB) World Taxpayers Associations (organizations with state membership). See Diane Ring, "Who is Making International Tax Policy: International Organizations as Power Players in a High Stakes World" (2010) 33:3 Fordham Int'l LJ 649 at 652 & 653:

> "Although "hard" law, including international tax law, remains the formal province of the state, or two states in the case of tax treaties, such unilateral or bilateral exercises of tax policy are inadequate. Some questions

This brief theoretical exposition evokes the fundamental question of whether formation and settlement of the international tax regime was primarily driven by states' power, states' interest, or the successful propagation of knowledge by "epistemic communities". The answer would seem to be "all of the above". As Ring observes: "if regimes develop for different reasons, then the different theories may each be valid and informative for some subset of cases".[881]

In terms of her specific views on the current subject, Ring expresses skepticism towards the notion that power and distributional elements played a defining role in framing the double taxation regime that emerged from the 1920s. To support this perspective, the author highlights that the U.S. as one of the most powerful countries – from a creditor/debtor country classification – was willing to endorse with a pro-source assignment of taxing rights favoured by mainly debtor (capital importing) countries.[882] Notably, the U.S.'s position largely contrasted with that of the U.K., a similarly positioned major creditor (capital exporting) country after WW2. To buttresses her stance on this point, Ring emphasizes that developing countries – who typically have a major preference for source taxation – have often been the initiators of double tax treaties with developed countries. She asks: "why do the developing countries continue, for the most part, to participate in (and in fact often clamor for) bilateral treaties even on these general terms?"[883]

> can be settled through the bilateral treaty process, but many more benefit from the input and interaction of more than two states. This interaction is often prompted, facilitated, or structured by at least one international organization… Today, international organizations of varying size, scope, composition, and mission consider questions of transfer pricing, electronic commerce, financial instruments, and business restructurings, just to identify a few. In some cases, this work ultimately emerges in the form of a treaty, but the manifestation of these efforts has expanded far beyond the treaty format to include guidelines, recommendations, and topical reviews."

Alisson Christians has more recently pursued a similar research project. See Allison Christians, "International Tax Organizations" in Y Brauner, *Research Handbook on International Taxation* (Edward Elgar Publishing, 2020) 29

[881] Ring *ibid* at 113.

[882] *Ibid.*

[883] *Ibid* at 123–129.

Ring concludes that "of the two dominant views of regime formation, the neoliberalist view more accurately reflects the experience of the double taxation regime."[884] The author argues that although "the neorealist focus on power (including economic power) may be useful in explaining why one distributive rule prevails over another in some treaty negotiations, the neoliberalist model offers a more comprehensive understanding of the regime formation process".[885] She asserts that the core reason why countries continue to embrace tax treaties is that "the treaties provide benefits that the market has failed to provide – coordination of the tax rules between nations."[886] The author, however, acknowledges that a regime is more probable in respect of coordination between two developed countries than between a developed and developing country due to the likely skewed distributive consequences of a compromise in the latter case.[887]

Yariv Brauner, likewise, attempts to dispel the notion that LIDCs are somehow pressured to accept international tax standards that are detrimental to their revenue mobilization needs, pointing out, in contrast, that LIDCs actively seek to conclude tax treaties with HIDCs and LIDCs tremendously benefit from them.[888] The author asserts that:

> Developing countries have benefited from the current bilateral tax treaty practice immensely, as their enthusiasm to conclude as many treaties as possible with developed countries proves. They have never been forced, nor have they claimed to have been forced,

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[884] *Ibid* at 147.
[885] *Ibid.*
[886] *Ibid* at 129. The author argues that without some level of coordination the common goal of relieving double taxation might be ineffective, and, therefore, non-beneficial to these countries, especially because of differences in tax rules (such as those regarding definitions and source rules). According to the author, "where differences exist on these elements, double taxation will persist, even if, for example, both countries grant an FTC." *Ibid at* 132.
[887] *Ibid.* Returning to the subject in a latter piece, Ring appears less committal on whether either neorealists or neoliberals had more sway in getting states to form a regime to solve the problem of international tax competition. Ring, "Democracy, Sovereignty and Tax Competition" *supra* note _ at 593 ["At that stage, the strategy of sovereign deal making and negotiation moved to the fore. Consideration of this shift draws our attention to the running debate in international relations theory as to whether the neorealists or the neoliberals more accurately describe the nature of inter-state cooperation and regime formation. Does power shape the international world, or do the agreements that we see and the regimes that are formed reflect the market nature of interactions and the ever-present desire to produce a more efficient outcome? The tax competition controversy does not answer that century old debate, but it provides additional fodder for the theorists"].
[888] Brauner (Crystallization) *supra* note 817.

> into concluding a bilateral treaty with a developed country. In fact, in many cases the developing countries wish to conclude treaties with the developed countries, which often reject their overture.[889]

Patricia Brown acknowledges the importance of bargaining power in international tax regime formation, but argues, at least with regard to bilateral tax treaties, that developing countries have more bargaining power than is acknowledged in the literature. In support of her argument, the author points to empirical studies that seem to show developing countries getting their way when it comes to the terms of a tax treaty.[890] Summarising the analytical work of Wijnen & de Goede[891] on various provisions of the UNMTC that are contained in 1,811 tax treaties entered into between 1997 and 2013, the author narrates that:

> Although some provisions occur more often than others, their research suggests that developing countries have a fair amount of bargaining strength to achieve results that are important to them. For example, of the 1,811 treaties studied, 1,579 (approximately 87%) allowed the source State to tax royalties. Of the treaties between an OECD member and non-OECD member, 85% allowed for taxation of royalties by the source State. As between two non-OECD members, 94% of treaties provide for taxation of royalties by the source State, while only 72% of treaties between two OECD members did so. Moreover, 42% of the treaties included a rule expanding the definition of a permanent establishment to include the furnishing of services in a source State for a specified period (most often six months, but sometimes as low as one month). Again, the adoption rate for this provision was highest (58%) among treaties between two non-OECD members, but still significant (35%) in treaties between an OECD member and a non-OECD member, and between two OECD members (17%). Although the percentage of treaties adopting other provisions is frequently lower than for these examples, such alternative provisions still occur in hundreds of treaties.[892]

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[889] *Ibid* at 307–308. It is explained elsewhere that the lack of U.S. tax treaties with Latin American countries, for instance, may be due to a host of divergent factors, including timing and the absence of significant bilateral economic relations to warrant a treaty. Patricia Brown *supra* note 305. See also Picciotto *supra* note 773 at 57 ["Notably, despite extensive investment and trade between the USA and Latin America, the US has no treaty with any major Latin American country. This is due not only to the latter's insistence on the source principle, but also to the US Congress's rejection of the tax sparing credit, despite continued pressure from the foreign trade lobby".]

[890] Patricia Brown *supra* note 305.

[891] Wim Wijnen & Jan de Goede, "The UN Model in Practice 1997-2013" (2014) 68 Bull Int'l Tax'n 118, cited in Patricia Brown *ibid* at 400.

[892] Patricia Brown *supra* note 305 at 400-401

Brown observes that many of the tax treaties signed by developing countries with developed countries (including OECD members) contain source taxation rules that are more favourable than the prescriptions of the OECD MTC, and, sometimes, even the UNMTC. This leads the author to conclude that these model conventions do not define tax treaty practice but are mere frameworks for commencing negotiation.[893]

Critics might respond that these positive perspectives do not sufficiently reflect the reality of power relations in international tax regime formation, especially Ring's stance on the decisiveness of interest alignment vis-à-vis power play in the initial crystallization of the double tax regime. It is important to note, however, that neither Brauner nor Brown dismisses nor downplays the decisiveness of great power in the initial regime formation, as their contentions respond specifically to contemporary notions of power play in tax treaties negotiation.[894] But even so, the observations made by Brauner and Brown respectively may not themselves reflect a power shift between HIDCs and LIDCs but may instead be explained as outcomes that evidence some of the shifting attitudes in international tax relations, which are best reflected in HIDCs' increasing realization of the imperative of participating in more equitable compromises of taxing rights with LIDCs (by less suppression of source taxation). Credit for some of that attitudinal shift may be attributed to the provocative works of commentators within and outside the academia who have consistently articulated the (potentially) detrimental effects of the initial tax treaty structure on revenue mobilization in LIDCs.[895] The relative recency of the tax treaties

[893] *Ibid* at 400. Indeed, it has been observed elsewhere that no tax treaties correspond wholly to the recommendations in the OECD MTC. See Mogens Rasmussen, *International Double Taxation* (Alphen aan den Rijn: Kluwer Law International, 2011) at 3.
[894] Both scholars engage the works of Dagan ("The Tax Treaties Myth"), while Brown also engages Brooks & Krever *supra* note 17.
[895] See, e.g., Musgrave & Musgrave *supra* note 8; Irish *supra* note 829.

surveyed by Wijnen & de Goede (1997–2013) – much of which draws from the more progressive stipulations of the UNMTC – is not lost in that point.

Progress of the sort featured by Wijnen & de Goede, if anything, justify the continued engagement of scholarship with the subject of power asymmetry in international tax relations. Absent such critical engagement it may be more difficult to see the kinds of progressive changes facilitated by the UNMTC, let alone something more radical. Moreover, the accommodation of piecemeal changes to tax rules does not necessarily exorcise the gamut of power mismatch in international tax relations, both in its subtle and brazen manifestations.

Vet, Cassimon, & de Vijver identify different facets of power in international tax governance.[896] First, because "the conception of society that predominates is a hangover from an earlier social formation", the continuing bias of the international tax regime towards residence country taxation is merely a perpetuation of the colonial era distribution of power which surrounded the birthing of the international tax regime.[897] Second, power disguises its true influence in its invisibility. Thus, "the unpoliticization of the distributional impact, for instance, the technically insulated discourse of international tax experts, gave the distributive decisions an unpolitical aura, while these decisions did mold the regime further toward the interests of transnational corporations".[898] In other words, because deliberations on international tax rules are typically presented as a technical matter, the emphatic overlay of power over what considerations become rules (and what considerations do not) is often disguised and underestimated. This appraisal holds true even as far back as 1921 when the Financial Committee of the League of Nations appointed the four economists as "technical experts" to design the double taxation framework.

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[896] Vet, Cassimon & Van de Vijver *supra* note 19.
[897] *Ibid* at 5.
[898] *Ibid*

The Financial Committee framed the mandate as a technical matter rather than a political exercise. However, as Allison Christians observes: "Far from being a technical or scientific matter, the questions asked implicate not just economics but also politics, culture, society, institutions, diplomacy, and above all, power".[899] In their report, the four economists themselves make a telling admission that the economic origin of an item of income could not be scientifically ascertained.[900]

Third, power manifests in the capacity to "shield the policy agenda from certain discussions and bring others to the fore of the debate."[901] A truly inclusive international tax governance framework that is devoid of power manipulation would look to put on the agenda issues that are important to all participants or all countries that would be affected by it.[902] Yet, as the OECD-G20 BEPS agenda revealed, more recently, HIDCs have the capacity – and willingness – to stay off the discussion of issues that are not of priority to them, e.g., the rebalancing of taxing rights between source and residence countries[903], or to limit the conversation to aspects of a broader issue that are of paramount importance to them, e.g., taxation of the digital economy.[904] Ultimately, matters of greater importance to LIDCs can be left off the menu.[905]

Further, power is also effective in constraining the rational circumference of those who are subject to work through the system which it perpetuates.[906] By presenting certain knowledge as

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[899] Allison Christians, "BEPS and the Power to Tax", in SA Rocha & A Christians, eds. *Tax Sovereignty in the BEPS Era* (Alphen aan den Rijn: Wolters Kluwer, 2017) at 7.
[900] See 1923 report *supra* note 144 at 36 & 38-39. Also, Christians *ibid* at 7–8 & 17.
[901] Vet, Cassimon, & de Vijver *supra* note 19 at 6.
[902] Okanga Okanga & Layla Latif, "Effective Taxation in Africa: Confronting Systemic Vulnerability through Inclusive Global Tax Governance" (2021) 2 AfJIEL 100.
[903] Burgers & Mosquera, *supra* note 824.
[904] Christians & Magalhães *supra* note 43.
[905] Oguttu *supra* note 698; Burgers & Mosquera "A Fair Slice" *supra* note 824; Intergovernmental Group of Twenty-Four, "Developing Countries' Role in International Tax Cooperation" (2017) G24 Working Paper.
[906] Vet, Cassimon, & de Vijver *supra* note 19 at 7.

the sole truth ("regimes of truth") on a particular subject, e.g., transfer pricing, we are conditioned to accept that the subject (tied to its economic nature) is inherently complex and there are no rational alternatives by which we can displace its complex existence.[907] Instead, we are compelled to sink further into that narrow corridor of maneuver, comforted occasionally by the emergence of piecemeal "solutions" which, as the sophisticated tax planning machinations of the chief beneficiaries of the status quo inevitably adapt, we are forced back to the same drawing board for "better" solutions.[908]

Vet, Cassimon, & de Vijver's focus on the "less visible expressions of power"[909] holds peculiar promise when we relate it to some of the less visible aces that influence LIDCs to surrender their tax jurisdiction. I have focused mainly on power in the context of tax treaty negotiation and things of the sort, but the reality is that the circumstances under which countries assimilate a 'culture of tax compromise' transcend that narrow contextualization.[910] There is a background to such cultural gravitation that is driven, at least in part, by the convergence of persuasive epistemic

[907] Ring accords relatively limited attention to the influence of pluralist views and epistemic elements in international tax regime formation, although in the latter case, the author does acknowledge some of the role played by a few groups of experts as building blocks of knowledge in developing the foundations of the double tax regime. Her less assertive position here is influenced by the views expressed by one of the four economists, Seligman, about how the League of Nations Technical Experts whose responsibility it was to operationalize the recommendations of the economists seemed to focus more on reaching some arrangement which could be politically agreeable to their respective countries. See Edwin RA Seligman, *Double Taxation and International Fiscal Cooperation* (New York: The Macmillan Co., 1928) 133-34, quoted in Graetz & O'Hear, *supra* note 34 at 1046 and Ring *ibid* at 146.

[908] It also comes to mind that the capacity of a country to deviate from established international norms or to unilaterally pioneer standards, especially standards that reach beyond its borders, is just as reflective of the power asymmetry in an international tax regime where common conformity is ordinarily expected. Historically, no country epitomizes this trend of political "maverickism" more than the United States. See Reuven Avi-Yonah, "Constructive Unilateralism: U.S. Leadership and International Taxation" (2016) 42:2 Int'l Tax J 17. The emergence of BRICS countries (Brazil, Russia, India, China and South Africa) as concrete challengers to established norms provides some counterbalance to the traditional perception of certain HIDCs as monopolists of assertive action in international tax. See Eccleston *supra* note 864; Jinyan Li, "China and BEPS: From Norm Taker to Norm Shaker" (2015) 69:6/7 Bulletin Int'l Tax'n 355; Thassiane Ayres Gossler - Transfer Pricing Rules in the BRICS World: A Shifting Balance in Global Taxation Governance? (LLM Thesis, University of Western Ontario, 2017). This is further discussed in chapter 3.

[909] Vet, Cassimon, & de Vijver *supra* note 19 at 7.

[910] Although tax compromise, or more specifically tax relief, is often implemented through tax treaty stipulations, the norm is only pervasive because most countries have come to accept it as imperative, despite its erosive effect on domestic revenue mobilization. It is, therefore, necessary to acknowledge how this "culture" became so pervasive.

orientations, and, perhaps less overtly by the ubiquitous institutional propagation of certain ideas. Therefore, if we look beyond the initial formation of the double tax regime and dig further into how "giving up" taxing rights became the universally acceptable "good tax behaviour", the influence that Global North institutions and experts have had on LIDCs' willingness to give up taxing rights becomes evident.[911] In this sense, I argue that this so-called culture of tax compromise that is rampant in LIDCs is partly a product of legal transplants, largely midwifed by Global North institutions and experts.

The concept of "legal transplantation", according to its acclaimed proponent Alan Watson,[912] is "the moving of a rule or system of law from one country to another, or from one people to another".[913] There are contrasting views on the plausibility of legal transplants. Some scholars opine that transplants are not possible because a true transplant must entail the same application of the rules in the recipient country as they were in the source country[914], while others are more receptive to the notion of legal transplantation, albeit with altered perspectives on the realization of the phenomenon.[915] This thesis does not delve into that debate, but I am willing to accept, at least at a minimal degree, the possibility that the laws and policies of one country or a few

[911] Historically, Global North experts have enjoyed an epistemic monopoly in expounding the economic principles that underpin taxation and tax policy. For historical evolution of economics, see, e.g., Steven G Medema & Warren J Samuels, eds, *The History of Economic Thought: A Reader* (London and New York: Routledge, 2003); Alessandro Roncaglia, *The Wealth of Ideas: A History of Economic Thought* (Cambridge, UK: Cambridge University Press. 2005); Ernesto Screpanti, *History of Economic Thought*, Translated by David Field & Lynn Kirby (New York: Oxford University Press, 2nd ed, 2005); William J Barber, *A History of Economic Thought*, 1st Wesleyan ed (Middletown, Conn: Wesleyan University Press. 2009); Jurgen G Backhaus, ed, *Handbook of the History of Economic Thought: Insights on the Founders of Modern Economics* (New York: Springer, 2012). An implication of this epistemic monopoly is that LIDCs' perception of economics – in terms of what creates value and entitles a country to tax – and its implications for the assertion of tax jurisdiction is fairly rooted in – and perhaps confined – a silo of transposed theoretical suppositions and norms.

[912] Alan Watson, *Legal Transplants: An Approach to Comparative Law* (Charlottesville: University of Virginia Press, 1974).

[913] Alan Watson, *Legal Transplants: An Approach to Comparative Law* (Athens: University of Georgia Press, 2nd ed, 1993) at 21. Watson here envisages that while rules may move from one country to another their eventual application in the recipient country may differ from their origin.

[914] Pierre Legrand, "The Impossibility of 'Legal Transplants'" (1997) 4 Maastricht J. Euro & Comp L 111.

[915] For example, Esin Örücü, "Law as Transposition" (2002) 51:2 The Int'l & Comp LQ 205.

countries, become assimilated into another country's *corpus juris.* I am also willing to accept that position as a fact of international tax law.

The view that the international tax regime is a product of legal transplants is shared by Sunita Jogarajan.[916] According to Jogarajan, transplantation takes different forms: (1) the transplant of tax laws from one country to another; (2) the imposition of tax laws by a multinational organization such as the European Union Court of Justice; and (3) the transplantation of tax laws through the international tax regime.[917] The author uses the third category to analyze the international tax regime, arguing that the tax laws or principles of one or a small number of countries were transplanted to the League of Nations at the onset of the regime and from then these same laws or principles were transplanted to a large number of countries,[918] aided in large part by the cultural non-specificity and universal applicability of the general features of international tax.[919]

Many of the countries that implement the initial international tax compromise had not attained sovereign status when the compromise was structured and, for that reason, had zero direct participation in its formation. Yet, many of these countries – like the former colonies of Western European countries who only gained independence after WW2 – broadly incorporated this compromise framework into their tax systems. Many have signed tax treaties with HIDCs in

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[916] Sunita Jogarajan, "The Origins of the International Tax Regime", in Y Brauner, ed, *Research Handbook on International Taxation* (Northampton, U.S.: Edward Elgar, 2020) 13.
[917] *Ibid* at 16–17.
[918] *Ibid* at 17. See also Irma Johanna Mosquera Valderrama, "Policy Note: The Study of the BEPS 4 Minimum Standards as A Legal Transplant: A Methodological Framework" (2020) 48:8 Intertax 719; Roberto Codorniz Leite Pereira, "The Emergence of Transparency and Exchange of Information for Tax Purposes on Request as an International Tax Custom" (2020) 48:6/7 Intertax 624 [contending that transparency and exchange of information on request has become an international tax custom which operates without regard to a domestic tax interest requirement or bank secrecy for tax purposes with extensive safeguards to protect confidentiality of the information exchanged. The author further contends that "international organizations and global forums with expertise in tax matters (especially the OECD, UN, and Global Forum on Transparency and Exchange of Information for Tax Purposes) are performing a fundamental role that includes influencing states' practices and *opinio juris* with soft law instruments and peer review procedures that ultimately influence the development of hard law in tax matters, a sphere traditionally conceived as being exclusive to states".].
[919] Jogarajan *supra* note 916 at 27.

pursuit of deeper initiation into the international tax club. How do these countries come to be so persuaded that it was wise to structure their tax systems to give up tax revenue? One rational explanation is the influence of predominantly Global North economists, experts, and institutions who, as quasi-successors to the League of Nations, played significant roles in convincing LIDCs that it was in their best interest to structure their tax systems in certain ways, as a test for participation in a rules-based international order.[920]

Experts from HIDCs – a so-called "cosmopolitan tax elite" – have had an enduring influence on tax policy in developing and emerging economies, especially since the much-heralded Shoup mission to Japan, which commenced in 1949.[921] Since then, HIDCs and HIDC-controlled institutions like the IMF and the World Bank have significantly shaped tax policy development in LIDCs, sometimes as a precondition for donor assistance.[922] Western-style institutions led tax policy missions to African countries in the 1960s – a period when many of these countries only just gained independence – on the advice of leading economists that the new states should prioritize the development of efficient tax systems.[923] Some of those missions – for instance, one led by the International Bank for Reconstruction and Development (IBRD) to Tanganyika (now Tanzania) in 1959/1960 – led to the adoption of a low corporate tax rate policy by the East African state.[924]

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[920] See Richard M Bird & Roy W Bahl, "Tax Policy in Developing Countries: Looking Back and Forward" (2008) 61:2 NTJ 279. This suggests that not only have Global North experts had a near exclusive epistemic footprint on the conceptualization of international tax norms, but they have also played an impactful role in the proliferation and entrenchment of these norms across the globe.

[921] Kim Brooks, "Portrait of A Tax Transplant Artist" (2020) 48:8/9 Intertax 698 at 699, 702. See also Shoup Mission, Report on Japanese Taxation (1949); Carl S. Shoup, John F. Due, Lyle C. Fitch, Donald MacDougall, Oliver S. Oldman & Stanley S. Surrey, *The Fiscal System of Venezuela: A Report* (Baltimore: John Hopkins Press, 1959); Carl S Shoup, Douglas Dosser, Rudolph G Penner & William S Vickrey, *The Tax System of Liberia: Report of the Tax Mission* (New York & London: Columbia University Press, 1970).

[922] Fjeldstad *supra* note 215.

[923] Nicholas Kaldor, "Will Underdeveloped Countries Learn to Tax?" (1963) 41:2 Foreign Affairs 410.

[924] IBRD, *The Economic Development of Tanganyika. International Bank for Reconstruction and Development* (Baltimore: The Johns Hopkins Press, 1961).

The rationale was that greater revenue was better sought, not by imposing higher tax rates, but by the expansion of economic activities, which could be facilitated by low taxes.[925]

Perhaps, at no time was this navigation towards lower-rate taxation more rapid than in the 1980s and 1990s when, in keeping with the Western-engineered neoliberal trends of the times,[926] LIDCs were persuaded to embrace various structural adjustment and trade liberalization policies, e.g., relaxing trade barriers and cutting down or abolishing taxes,[927] mostly instigated by HIDC governments, Western tax experts and powerful transnational lending agencies like the International Monetary Fund (IMF) and the World Bank.[928] That period witnessed the proliferation of "mass produced" tax reform in LIDCs without adequate deference to the suitability of those reforms to specific local circumstances.[929] These transpositions of policy norms epitomize the external tax policy constraints that alien institutions impose on LIDCs[930] and deserves some credit

[925] *Ibid* at 327–328.
[926] Vito Tanzi, "The Response of Other Industrial Countries to the U.S. Tax Reform Act" (1987) 40 Nat Tax J 399; Manfred B Steger & Ravi K Roy, *Neoliberalism – A Very Short Introduction* (New York: Oxford University Press, 2010).
[927] Wayne R Thirsk, *Tax Reform in Developing Countries. Regional and Sector Studies* (Washington DC: World Bank, 1997); Eunyoung Ha & Melissa Rogers, "What's Left to Tax? Partisan Reallocation of Trade Taxation in Less Developed Countries" (2017) 70:3 Pol Res Qtly 495; Julia Cage & Lucie Gadenne, "Tax Revenues and the Fiscal Cost of Trade Liberalization, 1792–2006" (2018) 70 Explorations in Econ History 1; Lukas Hakelberg & Thomas Rixen, "Is Neoliberalism Still Spreading? The Impact of International Cooperation on Capital Taxation" (2020) 28:5 Rev Int'l Pol Econ 1142.
[928] Malcolm Gillis "Micro- and Macroeconomics of Tax Reform: Indonesia", in R Bird & O Oldman, eds, *Taxation in Developing Countries* (Baltimore & London: The Johns Hopkins University Press, 1990) 76 at 77–78; Thiersk *ibid*; Cage & Gadenne *ibid.*
[929] Miranda Stewart & Sunita Jogarajan, "The International Monetary Fund and Tax Reform" (2004) 2004:2 BTR 146.
[930] Allison Christians, "Global Trends and Constraints on Tax Policy in the Least Developed Countries" (2010) 42 UBC L Rev 239 at 274 ["Decisions made by and for the developed world about how to foster and encourage globalization through international tax policy limit the range of tax policy strategies available to the world's least developed countries."]. The IMF, for instance, shaped tax policy in LIDCs by imposing tax reform as lending preconditions and/or through delivery of technical assistance in tax matters. Stewart & Jogarajan *supra* note 929 at 147.

for materializing a deep-rooted culture of taxing rights surrender – one that ultimately crystallizes in a market failure of harmful international tax competition.[931]

When we take this totality of "histo-political" factors into consideration we can better appreciate the systematic architecture of the taxing rights allocation compromises that stacked the distributional balance of international economic integration against LIDCs. These political factors remain relevant players in the distributional dimensions that now entangle the emerging Pillar One framework. Political and economic power continues to play an important role in shaping the important subject of who gets what and how is that decided? How inclusive is the OECD BEPS Inclusive Framework? To what extent is the tax sovereignty of countries at stake? Who is else is involved in the tax policies that are being churned out? These are the questions that I engage with for the rest of this chapter.

3.5.2 Inclusivity: To the Dance Tune of Great Power

The OECD has enjoyed the mandate to manage the most extensive multilateral effort to reform international tax rules in a century. Perhaps in a bid to confront some of the skepticism surrounding its own legitimacy as a global tax body, the OECD has, since the commissioning of the "Inclusive Framework" in July 2016, been keen to emphasize that states involved in the Inclusive Framework have been doing so "on an equal footing".[932] To what extent is this claim

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[931] See Genschel & Rixen *supra* note 110 at 164 [discussing the international tax regime as a transnational legal order (TLO). According to the authors, TLOs are formed to solve policy problems of a cross-border nature. The formation of a TLO often triggers another cross-border problem, which in turns necessitates the creation of a new TLO to deal with the emergent problem. They effectively concretize this theory by demonstrating how the creation of the double taxation regime gave rise to the problem of tax competition, which countries now seek to resolve through the creation of anti-BEPS regimes].

[932] See, e.g., OECD, "Economic Impact Assessment" *supra* note 771 at 3; OECD, *Addressing the Tax Challenges Arising from the Digitalisation of the Economy: Statement on a Two-Pillar Solution* (Paris: OECD, July 2021) at 10; OECD, *OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank governors* (Paris: OECD, 2021) at 51 ("In June 2016, at the request of the G20, the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework) was established in Kyoto, Japan with an initial membership of 89 countries and jurisdictions. The Inclusive Framework now includes 140 members, who, on an equal footing, monitor the implementation and contribute to the development of measures to combat Base Erosion and Profit Shifting (BEPS)").

of inclusivity true? As I discussed in chapter 2, there are observers of the process who would dispute the OECD's claims of inclusivity – and legitimacy.[933] In a piece that I co-authored with my doctoral research counterpart, Lyla Latif, of the University of Warwick, U.K., I discussed the subject of inclusivity in contemporary international tax governance.[934] In that piece, I identified three distinct dimensions of inclusivity: procedural inclusivity, subject matter inclusivity, and output inclusivity.[935] The first entails that all interested states should have equal opportunities of participation in all aspects of international tax regime formation. The second entails that the international tax reform agenda should contain matters of importance to all states – or class of states – regardless of status. In other words, "Action Plans" should not be limited to the tax issues that are of elevated importance to certain states, to the exclusion of others. The third dimension of inclusivity entails that the outcomes that are reached in regime formation should adequately accommodate the perspectives of all invested states, again, regardless of status or influence capital. That is the spirit of a compromise, after all. I am happy to adopt this framework for my current analysis. However, I limit my analysis here to the first and third aspects: procedural inclusivity and output inclusivity. I consider the question of subject inclusivity to be redundant since this entire chapter focuses on one subject: addressing the tax challenges of economic digitalization. I examine, mainly, whether the process that led to the conclusion of the Pillar One tax compromise adequately includes LIDCs, i.e., "on an equal footing", and whether the output reflects an adequate measure of deference to the will of LIDCs.

It is important, first, to reiterate that the process that produced the Pillar One compromise is being managed by the OECD, a body that is answerable to only its members, who, incidentally,

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[933] See e.g., Magalhaes *supra* note _; Vet, Cassimon & de Vijver *supra* note 19.

[934] Okanga & Latif *supra* note 902. My reference to "I" in this context is for convenience of drafting and should be read to reflect the plural "we".

[935] *Ibid.*

make up less than a quarter of the world's countries.[936] The reform process "commenced" in 2012 when the G20, another exclusive club, mandated the OECD to begin the process of reforming a flawed international tax regime.[937] It has been observed that global powers, through the G20, only became keen to address BEPS problems after the 2008 global financial crisis which devasted the economies of rich countries and forced them to dole out huge bailout funds.[938] The OECD operated in this largely exclusive regalia when it commenced the process of churning out reform initiatives to the rest of the world, including the 2013 BEPS report and the 15 Action Plans of 2015.[939] The Action items, also endorsed by the G20, followed the "top-down" approach that the G20 had used in other aspects of international economic law, including the fight against tax evasion.[940] However, following a trail of criticism about its lack of inclusivity, the OECD BEPS initiative was expanded in 2016 to include all states and jurisdictions that were desirous of participating in global tax policy reform especially in the next phase of the reform: BEPS 2.0.[941] This expansion represents the broadest inclusion of states in international tax reform since the post-war period when the OECD took control of the process from the League of Nations Fiscal Committee and its successor, the UN Tax Committee. However, despite this noticeable expansion, the Inclusive Framework continues to attract skepticism around its support of genuine

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[936] The OECD has less than 40 members. OECD, "OECD welcomes Costa Rica as its 38th Member" (25 May 2021) online: https://perma.cc/WLX6-3U2K.
[937] See Itai Grinberg, "Stabilizing Pillar One: Corporate Profit Reallocation in an Uncertain Environment" (2019) 23:1 Fla Tax Rev 130 at 135.
[938] See Eccleston *supra* note 864. See also OECD, *Addressing Base Erosion and Profit Shifting* (Paris: OECD, 2013); OECD, *Action Plan on Base Erosion and Profit Shifting* (Paris: OECD Publishing, 2013); Genschel & Rixen *supra* note 110; Mason *supra* note 429 at 355 & 364–367.
[939] Grinberg *supra* note 937 at 138.
[940] See, generally, Grinberg *ibid.*
[941] Adinda Wisse *et al, Report on the BEPS Inclusive Framework of the OECD* (2021). BEPS 2.0 is simply the descriptive phrase for the second phase of the OECD BEPS reform initiative. The term represents the two-pillar approach to international tax reform: i.e., Pillar One, which focuses on the allocation of taxing rights in the digital economy and Pillar Two, the aspect that establishes a global minimum tax for MNE groups. See Zoe Zhang, "What is BEPS 2.0? OECD's Two-Pillar Plan and Possible Impact on Multinational Enterprises", *China Briefing* (11 August 2021) online: https://perma.cc/F24V-UEKJ.

inclusivity and equal participation.[942] Michael Lennard, a former Chief of the International Tax Cooperation Section in the Financing for Sustainable Development Office of the UN and Secretary of the UN Tax Committee and a former tax treaty adviser in the OECD Tax Treaty Secretariat once queried that:

> Even in that body, non-OECD/G20 countries participate as "associates" on an "equal footing" (another undefined term). In determining to what extent the associates have truly become partners, an assessment would need to be done of the future drafting and interpreting roles of the OECD Secretariat (overwhelmingly, especially in policy development, from OECD country governments) and OECD Working Parties (such as WP 1 on treaties and WP 6 on transfer pricing), of which the non-OECD countries are only observers.[943]

Lennard's skepticism is echoed by a consistent critic of the OECD's role in international tax policy development, Professor Allison Christians, who, while responding to one of the Inclusive Framework's policy publications, remarked that "countries from outside a core group of key players have not really experienced inclusive participation."[944] This critic adds that "if anything, what is unified in the OECD approach is its commitment to an exclusive process of consensus building that replicates that of the founders of the international tax order, apparently unchanged by developments like inclusive participation and equal footing."[945]

Christians' criticism was not well received by the OECD. In a response crafted by one of the OECD Secretariat's senior officials, Ben Dickinson, the OECD retorted that:

> The 135 countries in the Inclusive Framework are working together on the new rules in a participatory way… The Inclusive Framework Steering Group comprises 24 countries from the OECD, G-20, and developing countries including in Africa from Ivory Coast, Nigeria,

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[942] See Wisse *et al supra* note 941.
[943] Michael Lennard, "Act of Creation: The OECD/G20 Test of "Value Creation" as a Basis for Taxing Rights and Its Relevance to Developing Countries" (2018) 25 Transnational Corporations 55 at 77.
[944] Allison Christians, "OECD Secretariat's Unified Approach: How to get things on a truly Equal Footing", *ICTD* (5 November 2019) online: https://perma.cc/278X-8GG2.
[945] *Ibid.*

> Senegal, and South Africa. In this body, 'the great powers' include China (vice chair) and India.[946]

Dickinson went on to detail some of the internal workings of the Inclusive Framework and concluded that "suggestions that there is no radical departure from the current rules on international taxation are therefore very wide of the mark."[947]

Christians' criticism of inclusivity in the BEPS process was not expressly supported by empirical evidence. Therefore, a fair observer might tend to ascribe the benefit of the doubt to the responses of Dickinson who is, after all, unlike the professor, an insider with firsthand knowledge of the workings of the Inclusive Framework. Perhaps, only LIDC participants are positioned to shed light on the level of participation and input that they can muster in the process, in a manner that effectively counters the assertions of Dickinson. This empirical substance was supplied in the form of research conducted by a group of tax policy scholars for the International Centre for Taxation and Development (ICTD) Christensen, Hearson & Randriamanalina, who find that:

> The IF's expansion has made little difference to the number of lower-income countries attending meetings at which the practical technical policy work is done, and that most members are fairly silent participants. This is partly because of well-documented structural obstacles not unique to the IF, but is exacerbated by some aspects of the OECD's decision-making processes, such as the pace and intensity of discussions, the culture of policymaking, the costs of attending regular meetings in Paris, and the absence of routine and timely translation of documents and meetings. This can make the OECD a daunting environment for member state delegates, but especially for those from lower-income countries. In addition, many have joined with no intention of influencing standards, but rather in pursuit of technical assistance or prestige, or under coercion from the European Union.[948]

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[946] Ben Dickinson, "The Inclusive Framework is Considering Radical Proposals, but in the Real World", *ICTD* (18 November 2019) online: https://perma.cc/6HZ8-ND3N.
[947] *Ibid.*
[948] Rasmus Corlin Christensen, Martin Hearson & Tovony Randriamanalina, "At the Table, Off the Menu? Assessing the Participation of Lower-Income Countries in Global Tax Negotiations" (2020) ICTD Working Paper 115 at 8.

These findings highlight some of the structural barriers to inclusivity that confronts LIDCs and infuse substance to the claims of scholars like Christians who attack the fairness of the Inclusive Framework. African representative bodies like ATAF and the West African Tax Administration Forum (WATAF) have echoed the alarm on their members' inability to fully participate in the process. In a 2020 statement, ATAF addressed both the technical and political intricacies of the Inclusive Framework process and the rush to stampede its members into ill-informed commitments:

> [w]e are very concerned that the political and technical complexities of the Inclusive Framework proposals and the timing of the process that aims for a global agreement by the end of 2020 means it is extremely challenging for many of our members to fully participate in the Inclusive Framework process and to ensure the new rules are fit for purpose for African countries. We are concerned that these complexities may mean some countries may commit to new rules without a full understanding of the revenue and investment implications for them.[949]

While the OECD secretariat has been committed to helping LIDCs overcome these challenges, the reality is that many countries simply cannot adapt to the pace of the process.[950] More recently, in 2021, WATAF also cast a disillusioned assessment over the participation opportunities of its members in the process that produced the Pillar One compromise:

> While we commend the effort of the G20, OECD Secretariat and the Inclusive Framework in securing this important deal, we are concerned however at the direction taken on some of the building blocks of the final IF statement, which was essentially developed by only a few members of the IF, which constitute the Steering Group of the Inclusive Framework (SGIF), while all other IF members were only invited to endorse the solution as presented by the Chair. We are more concerned that only one of our members participated in developing the rules, with that member objecting to the rules and abstaining from endorsing

[949] ATAF, "Media Statement on the Outcomes of the Inclusive Framework Meeting 29 to 30 January 2020" (31 January 2020) online: https://perma.cc/ET84-XM7P.
[950] Martin Hearson, "Corporate Tax Negotiations at the OECD: What's at Stake for Developing Countries in 2020?" (2020) ICTD Summary Brief Number 20 at 5.

> the fairness of the rules final outcome. This has left us uncomfortable about the fairness of the rules.[951]

Imaginably, the perceived lack of genuine inclusivity is not without consequence. In their 2019 piece, Christians & Magalhaes discuss how the "OECD Unified Approach" a policy framework that was designed by the OECD Secretariat and metamorphosed into the Pillar One deal, incorporated the nexus and profit allocation features of two proposals – user participation and marketing intangibles – that were favoured by OECD countries but excluded the SEP method that is favored by mostly developing countries.[952] The implication, according to the authors, is the reinforcement of an international tax regime that reserves most of the tax gains for HIDCs.[953]

Considering the skepticism trailing the inclusivity of the Inclusive Framework, it is not surprising that when a consensus on Pillar One was reached, the OECD was keen to emphasize that developing countries were major players in the entire BEPS 2.0 compromise. A recent OECD statement in this respect is reproduced as follows:

> Developing countries (particularly those in Africa, and with the support of the African Tax Administration Forum (ATAF)) have had a significant influence on the agreement. For example, on Pillar One, the agreement includes a commitment to reduce the scope threshold in 7 years (provided the system is operating as intended), which will result in a bigger pool of profits to be reallocated to markets; the nexus threshold – the point at which developing countries would see an allocation under Pillar One from an in-scope MNE – is set at a low level (EUR 1 million, reduced to EUR 250 000 for the smallest countries) so as to maximise the number of countries that will see revenue benefits; an

[951] WATAF Admin, "WATAF Commentary on the OECD/G20Inclusive Framework Two-Pillar Solution to Address the Tax Challenges", (8 October 2021) online: https://perma.cc/JC52-43FW.
[952] Christians & Magalhaes *supra* note 43; Gupta *supra* note 436.
[953] *Ibid* at 1175–1176 ["[u]sing the term "market jurisdictions" instead allows a strategic narrowing of scope while maintaining a broad enough terrain to accommodate the residence and source interests of members and other key consumer market states. A focus on the OECD consumer base as the market is a metric that, by definition, tends to favour the biggest consumer markets in relation to small-market, low-income countries—for example, those that heavily rely on exports of natural resources—which stand to be apportioned the least. Given the disparate levels of consumption across the globe, a market-based system would mostly benefit relatively more affluent countries and, in the best-case scenario, some emerging ones. Accordingly, no matter which of the proposals prevails, the result will be the reinforcement of a new global consensus on tax allocation that seems destined to favour the companies and governments of relatively affluent states."].

> elective option on tax certainty which will help ensure that countries which have no or only very small numbers of disputes do not get tied up in mandatory dispute resolution processes; Pillar One also includes a commitment to develop simplified, streamlined approaches, with a particular focus on the needs of low capacity countries, to the application to transfer pricing rules to certain arrangements that are very often the subject of tax disputes and, under Pillar Two, the guaranteed availability of the Subject to tax rule (STTR). These elements contributed to a balanced agreement for all parties in the negotiations.[954]

The foregoing statement reflects attempts at output inclusivity in both the Pillar One and Pillar Two compromises. Yet, the historical context and "top-down" path to that consensus leaves little doubt about the effect of power asymmetry in its formation. Perhaps, because an estimated more than 63% of in-scope MNEs are U.S.-headquartered companies,[955] the U.S. has been the single biggest player in the Pillar One compromise. Without U.S. cooperation, the deal was probably doomed.[956] The U.S. singlehandedly held up consensus for a significant time.[957] Exclusive deals were cut between countries to stem the trend of DSTs.[958] At some point the U.S. insisted on a "safe harbor" rule that would have allowed MNEs to opt in or out of the proposed Pillar One tax regime.[959] A deal became feasible only after the inauguration of the Biden administration and the willingness of that administration to compromise.[960] One outcome of that compromise was a

[954] OECD Two-Pillar Solution *supra* note 445 at 19.
[955] Devereux & Simmler *supra* note 633 at 5.
[956] Aitor Navarro, "The Allocation of Taxing Rights under Pillar One of the OECD Proposal" in F Haase & G Kofler, eds, *OUP Handbook of International Tax Law* (2021) at 11 (forthcoming).
[957] France 24, "Very clear' US is Blocking Digital Tax Talks, Says French Finance Minister", *France 24* (9 September 2020) online: https://perma.cc/LYY3-XKPV.
[958] Elizabeth Schulze, "US and France have Reached a Deal on Digital Tax, Macron Says", *EDT* (August 26, 2019), https://perma.cc/GK56-FEJ7.
[959] See Tax Journal, "US Suggests Safe Harbour Regime for OECD Pillar One Proposal", *Tax Journal* (11 December 2019) online: https://perma.cc/7EZ9-JPYC; Shepard Smith, "U.S. Drops 'Safe Harbor' Demand, Raising Hopes for Global Tax Deal", *CNBC* (26 February 2021) online: https://perma.cc/4EY5-NDYP.
[960] See Julie Martin, "U.S. Offers New "Pillar One" Compromise plan for Taxing Large Multinationals", *MNE Tax* (8 April 2021) online: https://perma.cc/G63E-TVTS. In pushing for a consensus, the U.S. claimed to put the "needs" of developing countries at the center of its approach to the OECD tax reform effort. In her letter to the G20, seeking to renew coordination in the IF, U.S. Treasury Secretary Janet Yellen, outlined the Biden-Harris Administration's commitment to the Paris Agreement, to fairness in the international tax system, and to putting the needs of developing countries on the international agenda. This position is amplified in the U.S. Government Presentation, which reiterates

framework with a much narrower scope than previously contemplated.[961] The Pillar One compromise turned out as something that was first developed by the OECD Secretariat (knitted together from three proposals),[962] streamlined by the OECD Secretariat after receiving public comments,[963] reengineered by the U.S. government,[964] and endorsed by G7 countries,[965] before its eventual adoption by individual Inclusive Framework member states,[966] as well as G20 countries distinctly.[967] At the stage of inclusive adoption, the perception is that not much room is left for meaningful change, except, perhaps, to accommodate the priorities of some OECD states who insisted on alterations to the language of the Pillar Two deal.[968] Does a compromise that embodies the engagement of all countries "on an equal footing" require these exclusive stages of design and approval? A keen observer, Tove Maria Ryding comments that:

> An approach where smaller clubs of rich and powerful countries steer the outcome of Inclusive Framework negotiations raises some specific concerns. Especially for smaller and less rich and powerful countries that are members of the Inclusive Framework, but not of the powerful decision-making clubs, it brings the risk that they will be pressured into agreements that do not reflect their views and interests. It also brings the risk of generating outcomes of the Inclusive Framework negotiations that are biased in favor of a particular group of countries.[969]

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that the U.S. is "prepared to be flexible regarding nexus thresholds to ensure that Pillar 1 benefits developing countries".

961 See Jefferson VanderWolk, *et al,* "The Biden Administration's International Tax Proposals: Will They Fly?", *Tax Journal* (6 May 2021) online: https://perma.cc/J22S-64QT.

962 See OECD, "Unified Approach" *supra* note 443.

963 See OECD Pillar One Blueprint *supra* note 443.

964 Martin *supra* note 960.

965 "G7 Finance Ministers Agree Historic Global Tax Agreement", *G7 UK* (5 June 2021) online: https://perma.cc/WV2K-HBV8.

966 Leigh Thomas, "136 Countries Have Agreed to a Global Minimum Tax Rate. Here's What It Means", *World Economic Forum* (1 November 2021) online: https://perma.cc/XNE4-QEGF.

967 Mounia Benabdallah, Mary C Bennett & Kate Alexander, "G20 supports latest Pillar One and Pillar Two proposals", *Baker McKenzie* (13 July 2021) online: https://perma.cc/9LL3-4H93.

968 "Ireland, Estonia and Hungary Sign up to Global Tax Reform", *ICAEW* (12 October 2021) online: https://perma.cc/7UZ9-H75H.

969 Tove Maria Ryding, "Who Is Really at the Table when Global Tax Rules get Decided?" (2021) Eurodad & Financial Transparency Coalition Briefing Paper 1 at 2.

I can agree with this summation. I imagine that no close observer would be innately surprised by the lack of "equal footing" on which countries "negotiate". Even the OECD has found cause to lose guard on its own pretense of inclusivity and equality. The remarks of the Director, OECD Centre for Tax Policy and Administration, Pascal Saint-Amans, captured in 2019, bears as much:

> Now, we are pragmatic. If you have all the big guys and a significant chunk of the small guys saying 'yes we [should] do it,' then the thing happens. Everyone must be involved, though.[970]

It seems that Mr. Saint-Amans was more forthcoming than Mr. Dickinson, whom I quoted earlier, in his appraisal of the disparity between rule makers and rule takers. It might well be that inclusivity is understood to mean that "the small guys" can be heard but not appeased – at least not in terms of their core demands. After all, non-OECD countries have also engaged with the Inclusive Framework at group level, as a way to combine strengths to extract more equitable outcomes.[971]

The Intergovernmental Group of Twenty Four (G24), a group of developing countries from Africa, Asia and the Americas, has served as a collective voice for its members, making various representations on their behalf.[972] From the onset of the Inclusive Framework process, the G24 was a main backer of the SEP proposal as a framework for the allocation of taxing rights to

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[970] Julie Martin, "Unanimity not required to update global rules for taxing multinational groups, OECD's Saint-Amans says", *MNE Tax* (18 October 2019) online: https://perma.cc/SP9Z-CXHW.

[971] See Nikolai Milogolov & Azamat Berberov, "The Digital Tax Reform for Africa: Customised or One-size-fits all Approach?" (2021) Int'l Rev of Law, Computers & Tech 1 at 17 [urging African countries to coordinate their positions to increase their bargaining power in the pillar one negotiations.

[972] The Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development (G-24) consists of 28 member countries as well as China (as a "special invitee"): Argentina, Algeria, Brazil, Colombia, DR Congo, Cote D'Ivoire, Ecuador, Egypt, Ethiopia, Gabon, Ghana, Guatemala, Haiti, India, Iran, Kenya, Lebanon, Mexico, Morocco, Nigeria, Pakistan, Peru, Philippines, South Africa, Sri Lanka, Syria, Trinidad and Tobago and Venezuela. Most of these countries are also members of the Inclusive Framework. See Doug Connolly, "G-24 warns that global tax deal will fail without better terms for developing countries", *MNE Tax* (21 September 2021) online: https://perma.cc/FR4E-6ZZV.

market states.[973] When the OECD Secretariat combined three different proposals – SEP, user participation, and marketing intangibles – into a single proposal (the Unified Approach), the G24 advocated the introduction of a fractional apportionment type profit allocation methodology into the taxation of MNEs under Pillar One, with withholding taxes as a collecting mechanism.[974] Mainly for reasons of administrative convenience, the G24 strongly opposed the split of MNEs' global profits into "routine" and "residual" and advocated that the total profits be allocated by fractional apportionment (based on agreed metrics such as global sales, assets, payroll and users).[975] The G24 also opposes the linkage of a mandatory dispute resolution mechanism (tax certainty) with Amount A, and advocates dispute prevention instead.[976]

In its more recent representations to the Inclusive Framework, the G24 recommended that Pillar One (Amount A) should contain a reallocation of not less than 30% of an MNE's residual profits. The G24 argues that because of the small number of companies and the nature of the business scope any share of residual profits that is lower than 30% would not ensure "any meaningful revenue for developing countries – particularly small and emerging economies".[977] The G24's recommendations were mostly ignored, even though important concessions were made for OECD countries like the UK and Ireland, prompting some observers to highlight the damaging

[973] G24, "Proposal for Addressing Tax Challenges Arising from Digitalisation" (17 January 2019) online: https://perma.cc/CSM9-EMAW at 3, paragraph 9 ["Under this rule, a taxable presence in a country would be created when a non-resident enterprise has a significant economic presence on the basis of factors that are evidence of purposeful and sustained interaction with the economy of that country via technology and other automated rules."].
[974] G24, "Comments of the G-241 on the OECD Secretariat Proposal for a Unified Approach to the Nexus and Profit Allocation Challenges Arising from the Digitalisation (Pillar 1)" (9 November 2019) online: https://perma.cc/GK8R-BE2P.
[975] *Ibid* at para 10–11.
[976] *Ibid* at para 5. The mandatory arbitration component is seen as a deal breaker for some G24 countries, especially African countries. See African Union, *Briefing for the Ministers on Taxing the Digital Economy and the Global Tax Debate* (The Extraordinary Specialised Technical Committee on Finance, Monetary Affairs, Economic Planning and Integration, 2020) at 13. It is one of the main reasons for Nigeria's unwillingness for accept the deal. See Oluwatobi *supra* note 596.
[977] G24, "Comments of the G-24 on the Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy agreed by 134 jurisdictions of the Inclusive Framework on the 1st of July 2021" (19 September 2021) online: https://perma.cc/KD9P-FY8F at paragraph 3.

effects of the compromise and to implore its rejection by LIDCs.[978] The G24 cited a recent IMF study showing that LIDCs could lose revenue under Pillar One, while countries with large markets would most likely gain revenue.[979]

ATAF has channeled the collective views of LIDCs on the African continent throughout the Inclusive Framework project. ATAF has echoed similarly strong concerns that the Amount A rules were extremely complex for African countries, that the complexity outweighed the revenue benefits that would accrue to market states, especially smaller market jurisdictions, and that the split between residual and routine profits would undermine inter-taxpayer equity:

> Where a business has a taxable presence in the market jurisdiction such as through a distribution activity, that jurisdiction will have taxing rights under the arm's length principle resulting in many cases in part of the routine profit of the MNE being taxed in that jurisdiction and in some cases some of the MNE's residual profit.[980]

Accordingly, ATAF rated the Pillar One (Amount A) proposal initiated by the U.S. as inadequate in terms of the amount of the profits to be reallocated to market states and advocated the reallocation of a portion of the MNE's total profits rather than only residual profit.[981] ATAF endorsed the inclusion of a global turnover threshold in Pillar One but strongly recommended that the threshold be lowered to €250 million, to expand the range of in-scope entities.[982] ATAF was able to claim victory points in some respects. The forum has expressed satisfaction with the broadening of Pillar One to include all sectors rather than the narrower scope proposed in the OECD Pillar One Blueprint.[983] The expansion of Pillar One to all sectors, rather than the narrow

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[978] See Adrian Falco *et al,* "G20 Global South Members: Uphold G77 Tax Interests – Not Those of the G7" *Global Tax Justice* (27 October 2021) online: https://perma.cc/VQD3-5QUU.
[979] IMF, *Digitalization and Taxation in Asia* (2021) DP/2021/017.
[980] ATAF, "ATAF Sends Revised Pillar One Proposals to the Inclusive Framework" (12 May 2021) online: https://perma.cc/Q5N4-2WAV.
[981] *Ibid.*
[982] *Ibid.*
[983] ATAF, "A New Era of International Taxation Rules – What Does This Mean for Africa?" (8 October 2021) online: https://perma.cc/3HGN-7AWH.

scoping previously contemplated in the Pillar One Blueprint; the exemption of the extractives sector;[984] a reduction of the nexus threshold from €5 million to €1 million and €250,000 (smaller jurisdictions) respectively; and the confined applicability of business line segmentation to very limited circumstances, which simplifies administration.[985] ATAF also claims victory in the toned-down application of mandatory arbitration, which it otherwise considers problematic for African countries:

> Together with the AUC, ATAF strongly opposed this as it would impose a costly and resource intensive process on many African countries which have limited capacity and where there is little risk of double taxation. ATAF has succeeded in obtaining agreement that for many African and other developing countries they will not have the mandatory dispute resolution mechanism imposed upon them, and instead an elective binding dispute resolution mechanism will be available for issues related to Amount A for developing countries that are eligible for deferral of their BEPS Action 14 [peer] review and have no or low levels of MAP disputes. The eligibility of a jurisdiction for this elective mechanism will be reviewed regularly; jurisdictions found ineligible by a review will remain ineligible in all subsequent years. This is a major achievement for Africa.[986]

ATAF, nonetheless, expressed regret that some vital concerns remain unresolved: the restriction of taxable profits to residual profits and the persistence with a 25% residual profit reallocation when, in the forum's view, at least 35% was required to fulfill meaningful reallocation.[987] ATAF, however, concludes with optimism that the deal would yield additional tax revenue for African

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[984] *Ibid* ["This is of great importance to African resource rich countries as minerals are generic goods that are sold and priced on the basis of their inherent characteristics, rather than on other factors such as marketing intangibles. The primary taxing right therefore should be allocated to the resource-producing country"]. Many LIDCs – especially African states – play host to large deposits of valuable extractives and rely heavily on the revenue from their extractive sectors. DR Congo is the biggest supplier of cobalt, but most of its Cobalt is sold in bigger markets like the US and China where the mineral is used to manufacture Apple's iPhones and other important electronic devices. Pillar One does the sensible thing by excluding extractives. See Centurion, "The OECD's Global Tax Deal and its Implications for Nigeria" (28 October 2021) online: https://perma.cc/5YHL-5AFZ.

[985] ATAF, *supra* note 983.

[986] *Ibid.*

[987] *Ibid.*

countries even though it does not address the broader issues of taxing rights distribution between residence and source countries that remain of priority to LIDCs.[988]

Despite the more favourable outcomes that ATAF was able to secure, it seems that the Inclusive Framework leaves a scar of resentment in the thoughts of LIDCs who remain unfulfilled with their level of participation in the OECD-led process. Perhaps, these states blame the process capture by more powerful countries for their inability to secure more favourable distributional outcomes, which may have led to the reluctance of Kenya, Nigeria, Pakistan, and Sri Lanka to sign-up. An immediate consequence of this state of discontent was a move by another active group of over 130 developing countries, the G77, to "rebel" against the skewed political process in the Inclusive Framework. In October 2021, shortly after the OECD released the text of the Two-Pillar compromise, the G77 and China initiated a resolution before the UN General Assembly to, *inter alia,* elevate the UN Tax Committee to the status of an intergovernmental UN tax body that would steer the ship of international tax reform.[989]

In support of this draft resolution, it has been noted that over one-third of the world's countries never took part in the Inclusive Framework negotiations:

> The fact that over 130 developing countries have now tabled a proposal to have an intergovernmental UN tax negotiation is a strong sign that they do not consider the discussion about global tax rules to be over"; and "the United Nations is the only forum where countries can participate on a truly equal footing.[990]

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[988] *Ibid.*

[989] United Nations General Assembly, *Seventy-sixth Session Draft Resolution: Promotion of international cooperation to combat illicit financial flows and strengthen good practices on assets return to foster sustainable development* (New York: UNGA, A/C.2/76/L.28, 15 October 2021) at paragraph 19.

[990] See Trove Ryding, "As G20 meets to rubberstamp OECD tax deal, 130+ developing countries push for UN tax body", *Eurodad* (29 October 2021) online: https://www.eurodad.org/g77_global_tax_body_un.

Chowdhary & Picciotto also lend support to the renewed calls for a world tax body under the UN, arguing that such a body would end institutional proliferation in international tax policy making and address and the inclusivity and legitimacy concerns surrounding the OECD Inclusive Framework.[991] Thus far, no concrete progress has been reported on the proposed resolution, but few would bet against it failing like all previous attempts to install an inclusive global tax body.

3.5.3 Sovereignty: Whipping Them In Line

Sovereignty is another important dimension of the Pillar One compromise. As I contend in chapter 2, the desire to reassert tax sovereignty and fiscal self-determination is central to the push by states in this century to reshape some of the fundamental principles of international taxation, particularly the principles allocating taxing rights between residence and source countries. The unwillingness of countries like Nigeria, Kenya, Sri Lanka, and Pakistan to accept the Pillar One compromise does not seem unrelated to their dissatisfaction with the deal's impairment of their tax jurisdiction. Countries in that mold of discontent with multilateral cooperation in the international tax regime seem to be left with three choices: remain loyal, exit, or remain and push for better.[992] However, none of these choices is particularly straightforward. If it were feasible, dissenting states would press for a broader scope of Pillar One, for instance, just as the UK secured a carveout for "regulated financial institutions"[993] and Ireland successfully insisted on altering the language of Pillar Two to suit its own tax competition policies.[994] Unfortunately, as Hearson observes, LIDCs

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[991] Abdul Muheet Chowdhary & Sol Picciotto, "Streamlining the Architecture of International Tax through a UN Framework Convention on Tax Cooperation" (2021) South Centre Tax Corporation Policy Brief No. 21.
[992] Magalhães, "Loyalty, Exit, and Voice" *supra* note 825.
[993] See Danish Mehboob, "Ireland and UK push back against US Proposal for Minimum Tax Rate", *Int'l Tax Rev* (24 May 2021) online: https://perma.cc/3X8N-79DE.
[994] See Cliff Taylor & Ellen O'Riordan, "Ireland One of 9 Countries to Hold Out on Signing OECD Global Tax Deal", *Irish Times* (1 July 2021) online: https://perma.cc/YE4E-B2C2; Lisa O'Carroll, "Ireland ends 12.5% Tax Rate in OECD Global Pact", *The Guardian* (7 October 2021) online: https://perma.cc/28HV-7ZP9. Ireland was able to extract some key concessions: the words "at least" would be dropped from the 15% minimum tax rate, which would allow Ireland to "retain its 12.5% corporate tax rate for firms below the €750million threshold – benefitting 99.9 % of the companies operating in Ireland – and, most importantly, the EU Commission agreed it will not seek to "gold plate"

lack the power to coerce international tax reforms out of other states and must make do with the piece that the G20 and the OECD avails them.[995]

Exiting would be an especially delicate option for LIDCs. It would require an exiting state to break rank with the OECD compromise and to legislate as it deems within its jurisdiction. That is, after all, what sovereign states are entitled to do. Such a state would be neither perturbed nor daunted by external influences as it asserts its tax sovereignty. Incidentally, that kind of autonomy does not exist in a post-Westphalian world.[996] If it does exist, I doubt that LIDCs are in a strong position to wield it.[997]

As I discuss in section 2.3.3.4, the threat of sanctions and trade counter-measures played an important role in the U.S.'s decision to reverse its attempts to impose source-based tax on international shipping in the early 20th century.[998] Eventually, countries agreed to reserve taxation of international shipping and air traffic to countries of residence, resulting in the current Article 8.[999] The path to the Pillar One tax deal, in some respects, mirrors the path to Article 8.

History does repeat itself. Due partly to frustration with the slow pace of BEPS 2.0 and the lack of consensus on Pillar One, many countries have experimented with different forms of unilateral digital tax measures.[1000] Some of the unilateral measures seek to adapt existing tax treaty principles

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the agreement when transposing it to EU law" – Dick Roche, "The Global Tax Marathon: Winners and Losers", *EURACTIV* (11 October 2021) online: https://perma.cc/RFU5-H6QC.

[995] Hearson, "The Challenges for Developing Countries in International Tax Justice" *supra* note 336 at 1933.

[996] See Dietsch, "Rethinking Sovereignty" *supra* note 110.

[997] See Okanga O Okanga, "The Political Economy of Nigeria's Digital Tax Experiment", *Afronomics Law* (1 July 2020) online: https://perma.cc/49JP-QQ25.

[998] Maisto *supra* note 354.

[999] *Ibid*.

[1000] See KPMG *supra* note 522. See also: Hadzhieva, Eli "Impact of Digitalisation on International Tax Matters: Challenges and Remedies" (2019) EU Parliament Policy Department for Economic, Scientific and Quality of Life Policies Directorate-General for Internal Policies Paper No. PE 626.078; European Commission, *Proposal for a Council Directive Laying down Rules relating to the Corporate Taxation of a Significant Digital Presence* (Brussels: EC, 2018) [EC Council Directive].

to the peculiarities of the digital economy[1001] while others attempt to impose DSTs and similar taxes.[1002] There has been one huge roadblock to these attempted reassertions of state sovereignty: the U.S. The U.S. has maintained strong opposition to any unilateral digital tax measure and contends that the burdens of these "discriminatory" taxes would fall disproportionately on U.S. MNEs, the tech giants.[1003] Given the bullish and sometimes unconventional manner in which the U.S. has been known to assert its own tax sovereignty, it would seem justifiable for other states to dismiss the U.S.'s protests as hypocritical.[1004] The problem, however, lies in power asymmetry, as reflected in the risk of U.S. sanctions and trade wars which may be potentially devastating on international trade.[1005] The U.S. has signalled its willingness to sanction any country that imposes digital tax on its tech companies[1006] and insists that it is the only country that is entitled to tax them, despite showing no willingness, currently, to tax those companies.[1007] As a consequence of this potential hostility, few countries have shown resolve to sidestep the search for global consensus in favour of asserting their own tax sovereignty. Countries that have experimented with a DST have mostly done so on an interim or tentative basis and shown a willingness to retract once a compromise can be reached.[1008] In the end, the 2021 compromise driven by the U.S. ensured that the number of in-scope U.S. companies was very limited compared to what would have obtained

[1001] This consists of Action 1 of the OECD BEPS Project as well as the European Union's digital PE proposal.
[1002] This consists of some radical changes to existing tax rules proposed or introduced by the European Union, as well as some individual states within and outside the EU.
[1003] See USTR Report on Spain *supra* note 638; USTR Report on France *supra* note 557.
[1004] See, e.g., Avi-Yonah, "Constructive Unilateralism" *supra* note 908; Alex Davis, "US Should Show More Respect Over FATCA - PBoC official" (2012/2013) 13:12 Operational Risk & Regulation 9.
[1005] Leanna Reeves, "US Shift on Pillar One is a Chance for 'Tax Peace', Says Saint-Amans", *Int'l Tax Rev* (6 May 2021) online: https://perma.cc/Q64E-WY8A.
[1006] David Lawder & Andrea Shalal, "U.S. to Announce, But Defer, Retaliation Over French Digital Tax: USTR", *Reuters* (9 July 2022) online: https://perma.cc/D85Y-3UJX; David J Ross, *et al,* "USTR Terminates Section 301 Actions on Digital Services Taxes In Austria, France, Italy, Spain And The United Kingdom; Treasury Announces DST Agreement With Turkey", *Mondaq* (27 November 2021) online: https://perma.cc/CES7-2PXS.
[1007] Ruth Mason, "The 2021 Compromise", *Tax Notes* (23 July 2021) online: https://perma.cc/UE3V-ZMQ3.
[1008] PWC Tax Policy Alert, "US Compromises with the UK, France, Italy, Spain and Austria on Digital Services Taxes and Trade Actions" (25 October 2021) online: https://perma.cc/9K89-G9CL.

under a compromise with a much smaller global turnover and profitability threshold. The U.S. ensured that the arrangement would, in principle, spread beyond highly digitalized businesses, put a stop to unilateral DSTs and secured a global minimum tax rate under the co-joined Pillar Two.[1009] Still, there are voices who feel that the U.S. has shortchanged itself by signing a deal that would mostly affect U.S. companies and render them globally less competitive.[1010]

States that are dissatisfied with the deal are left to weigh, very carefully, whether to play along or go their own way, in which case they may risk potential backlash from the great powers – perhaps, one great power. Thus far, Nigeria is one country that has starkly repudiated the party line. In April 2022, Nigeria reportedly opted out of the Two-Pillar deal, citing the reasons outlined in the preceding segment.[1011] Whatever the geopolitical implications, Nigeria's decision to exit the stage cannot be deemed unreasonable in view of reports like Oxfam's which demonstrate that Nigeria would be one of the countries to suffer a significant revenue hit from the deal's impairment of taxing rights.[1012] Presumably, Nigeria will forge ahead with its already established unilateral digital tax regime. Protagonists of multilateralism can only hope that other disgruntled countries do not follow Nigeria's exit course, otherwise the deal might unravel. As I highlight in the next segment, countries like Canada already have a stand-by unilateral legal framework for taxation of non-resident digitalized businesses that would become active if the Pillar One deal fails to reach implementation. While such unravelling remains a remote possibility, the current compliance figures demonstrate that most Inclusive Framework member states are "happy" to play along. This broad loyalty, on the one hand, suggests that countries, generally, prefer an

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[1009] Roche *supra* note 994; OECD, "Two-Pillar Solution" *supra* note 445.
[1010] WSJ Editorial Board, "The Global Tax Deal Is Bad for the U.S.", Wall Street Journal (8 July 2021) online: https://perma.cc/R7XZ-CJ88.
[1011] Ndubuisi Francis, "Nigeria Opts Out of Global Tax Deal, Cites Economic Impact", *This Day* (20 April 2020) online: https://perma.cc/JT3Y-WBZS.
[1012] Oxfam *supra* note 695.

"imperfect" deal to the potential chaos of unilateralism but, on the other hand, evidences a triumph of great power over national sovereignty and national interest. This capacity to keep countries in check is why some LIDCs may feel stuck in a tax deal that does not come close enough to meeting their perceptions of fairness.

3.5.4 Pluralism: Big Business and Civil Society

Diane Ring's contribution on international tax relations remains immensely valuable for not only highlighting the permeative influence of politics on the framing of international tax rules, but also for amplifying the point that these influences do not only emanate from sovereign states, but also from other invested parties looking to secure an ideal economic outcome for themselves.[1013] I am minded to conclude this section by reflecting on the discernible, often subtle, roles of non-state actors in the formation of the Pillar One deal. This perspective is relevant because the new tax deal, when implemented, will impact the tax obligations of in-scope businesses, and it is important to accommodate the viewpoints of these stakeholders on the potential economic ramifications of such a transformational global tax policy; and this is notwithstanding any perception that large digitalized business entities are chief beneficiaries of the legal order that countries aim to restructure and may seek to, as closely as possible, maintain the status quo.

Non-state actors, especially business stakeholders, have both historically and contemporarily tried to influence international tax policy. Taxpayers and tax professionals "actively seek to understand, influence and shape international tax law and policy".[1014] Their fingerprints can be

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[1013] Ring *supra* note 2.
[1014] Ring *supra* note 2 at 83. See Vet, Cassimon & de Vijver *supra* note 19 for an qualitative demonstration of how intense pluralist influences, particularly of big business and the tax advisory community, directly underpin the structure and content of the transactional profit split method of transfer pricing assessment, as contained in the OECD, *Revised Guidance on the Application of the Transactional Profit Split Method* (Paris: OECD Publishing, 2018).

spotted on the double taxation regime, tracing back as the early 1920s when the ICC initiated the League of Nations project to eliminate international double.[1015] The ICC's influence was also crucial to the establishment of the OECD as the main norm setting institution of international taxation. The ICC's disenchantment with the lack of multilateral consensus between capital importing and capital exporting countries on a double taxation relief model led it to push the newly formed OEEC to succeed the League of Nations' Fiscal Committee as the body with responsibility to frame such a model.[1016]

Although it is difficult to attribute such a high magnitude of influence to a single non-state actor in the present era, one cannot fail to acknowledge "smaller" bits of influence.[1017] In the current dispensation, the role of big business has been largely two-fold: technical contributions and political influence. One is to make "technical" suggestions to the OECD that may help to ensure that the new tax deal is sensitive to business. The OECD has taken representations from many businesses and business groups during its attempts to craft the new tax regime.[1018] The ICC is one of the business groups that have made representations at various stages of the deal[1019] and,

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[1015] Graetz & O'Hear *supra* note 34 at 1043-56, 1066-76 (discussing development of the foreign tax credit in the United States and of the International Chamber of Commerce's Double Taxation Committee's approach to the problem of double taxation).

[1016] Picciotto *supra* note 773 at 52.

[1017] Perhaps, the key difference between 1920 and 2020, so to speak, is that tax reform was mostly needed and, consequently, demanded by big business, who wanted to see double taxation go, while nowadays tax reform is largely driven by states (partly pressured by anti-abuse campaigners) anxious to secure their tax bases through, ironically, elimination of double non-taxation and base erosion. In these circumstances, the influence of big business is, understandably, more covert than a century ago when they were primary agitators for ending the "evil" of double taxation.

[1018] See OECD, "Public Comments Received on the Secretariat Proposal for a "Unified Approach" under Pillar One", *OECD* (15 November 2019) online: https://perma.cc/5G55-LPMA; OECD, "Tax challenges arising from digitalisation: Public comments received on the Pillar One and Pillar Two Blueprints", *OECD* (16 December 2020) online: https://perma.cc/GA2Y-5U65. See also Danish Mehboob, "Microsoft warns digital tax agenda may fail on its complexity", *Int'l Tax Review* (11 January 2021) online: https://perma.cc/L7TS-88YV.

[1019] ICC, "ICC Comments on OECD Public Consultation Document: Addressing the Tax Challenges of the Digitalisation of the Economy" (25 October 2019) online: https://perma.cc/8ZEM-2UKQ; ICC, "ICC Comments on OECD Public Consultation Document: Reports on the Pillar One and Pillar Two Blueprints: Tax Challenges Arising from Digitalisation" (14 December 2020) online: https://perma.cc/DU7U-BNJ2. See also ICC, "ICC Responds to G7 Deal on Taxation" (6 June 2021) online: https://perma.cc/Y7S6-WDC4.

understandably, has been keen to emphasize the importance of a compromise that is efficient and administrable.[1020]

Another important business body, Business at OECD (BIAC), has actively participated in the rules making process.[1021] BIAC has a permanent consultancy status at the OECD since its founding in 1962. BIAC emphasizes certainty and administrative feasibility in its representations.[1022] One of BIAC's core demands as regards Pillar One is that unilateral digital tax measures "must be definitely removed by all participating countries".[1023] This demand, which is not solely attributable to BIAC, is reflected as a core component of the Pillar One compromise.[1024] However, BIAC has also had cause to decry a lack of inclusion in the decision making process of the Inclusive Framework, noting that this lack of inclusion "will not lead to administrable outcomes".[1025]

Additionally, the business community exerts political pressure on decision makers to ensure that states do not act either unilaterally or multilaterally to impose taxes that undermine the commercial interests of the business community. For instance, in 2019, more than a dozen U.S. trade groups and the U.S. Chamber of Commerce urged the U.S. government to intervene to "block" a digital services tax touted by Canadian Prime Minister Justin Trudeau during that

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[1020] ICC, "ICC Calls for Coherent and Coordinated Implementation of International Tax Agreement" (13 October 2021) online: https://perma.cc/6Q56-5K96.
[1021] BIAC, "Ref: OECD/G20 Inclusive Framework on BEPS – Reports on Pillar One and Pillar Two Blueprints" (14 December 2020) online: https://perma.cc/ZC9D-EEZQ. BIAC, "Business at OECD (BIAC) Media Release: Business Calls for Clear Rules and Realistic Timelines as OECD Reaches Landmark Tax Deal", *BIAC* (11 October 2021) online: https://perma.cc/Y6V7-9XPP.
[1022] BIAC "Media Release" *ibid.* See also, Danish Mehboob, "BIAC Slams OECD Model Rules on Pillar Two for several Issues", *Int'l Tax Review* (14 January 2022) online: https://perma.cc/7EHC-NJPP.
[1023] BIAC "Written Response" *supra* note 1021 at 5.
[1024] See OECD Two-Pillar Solution *supra* note 445.
[1025] See William H Morris, Chair of BIAC letter to OECD Task Force on the Digital Economy (TFDE) and Working Party 11 on Aggressive Tax Avoidance, 16 November 2021, online: https://perma.cc/L2JN-5UV7.

year's general elections campaign.[1026] The groups claimed that the tax would undermine U.S. investment in Canada's technology market and threaten Canada's compliance with commitments under various trade agreements: the WTO, the North American Free Trade Agreement (NAFTA), and the United-States-Mexico-Canada Agreement (USMCA). They urged the U.S. government to rapidly engage with its Canadian counterpart to put the brakes on the proposed legislation.[1027] Whatever considerations prevailed, the Trudeau proposal stalled, as the country opted instead to focus on a multilateral compromise.[1028] In early 2022 when Canada again showed intent to move forward with the DST proposal, the U.S. Senate Finance Committee issued a statement urging the USTR to take retaliatory action if Canada went ahead.[1029] In February 2022, the USTR filed a formal complaint with the government of Canada, urging it to not proceed with the proposed DST law.[1030]

The cloud of rampant international tax abuse and structural obsolescence that overshadows the international tax regime has expanded the coast for political engagement by non-state actors to include civil society organisations (CSOs) who are primarily on the side of "tax justice". Organizations like Action Aid, Christian Aid, Oxfam, the BEPS Monitoring Group, and Tax Justice Network have emerged as frontline warriors for domestic and international tax justice,

[1026] Reuters, "U.S. Trade Groups Raise Alarm Over Canadian Digital Services Tax", *Reuters* (15 November 2019) online: https://perma.cc/4XTC-ENCV.
[1027] *Ibid.*
[1028] The U.S. threatened to retaliate against Canada if Canada proceeded to enact and implement the $540M proposal. See Janyce McGregor, "As U.S. threatens retaliation over digital taxes, Canada waits for OECD talks", *CBC* (22 January 2020) online: https://www.cbc.ca/news/politics/davos-digital-tax-wednesday-1.5436372.
[1029] Stephanie Soong Johnston, "USTR Must Push Back if Canada Moves on Digital Tax, Senators Say", *Tax Notes* (14 January 2022) online: https://perma.cc/ZX23-KCW4. Canada does not intend to enforce the DST law until at least 2024, in hopes of finding a final multilateral solution. See Gareth O Williams, "Canada and the New Digital Services Tax", *Laws on Lundell* (4 January 2022) online: https://perma.cc/8YLP-8NXG.
[1030] Reuters, "U.S. Files Formal Objections to Canada's Proposed Digital Tax" (22 February 2022) online: https://perma.cc/KH6G-BG5N.

mostly carrying the voice of LIDCs.[1031] CSOs have in some cases taken legal steps to void tax treaties that they deem erosive to the tax base of LIDCs.[1032] While scholars have previously decried the limited access of CSOs to international organizations like the OECD,[1033] scholars like Cees Peters, recognizing the important role that CSOs play in providing a moral balance to global tax governance, advocate that they be given a seat at the table.[1034] CSOs, like business stakeholders, may be viewed as wielders of soft power, and if for no other reason, the involvement of CSOs can help to counterbalance the influence of MNEs and business groups, to ensure that tax rules and compromises are forged with sufficient latitude for equity, as much as commercial efficiency. A global coalition of CSOs was quickly on hand to denounce the Two-Pillar compromise as a "deal of the rich" that "will not benefit developing countries.[1035]

[1031] See Richard Eccleston & Ainsley Elbra, eds, *Business, Civil Society and the 'New' Politics of Corporate Tax Justice* (Cheltenham, UK & Northampton, MA, USA: Edward Elgar Publishing, 2018); Wilson Prichard, "Improving Tax and Development Outcomes: What Next for Civil Society Engagement?", *Transparency Initiative* (2018) online: https://perma.cc/AUY7-GYUU; Samuel Sharp, Stephanie Sweet, & Alina Rocha Menocal, "Civil Society Engagement in Tax Reform", *CDN* (September 2019) online: https://cdn.odi.org/media/documents/12927.pdf; Fariya Mohiuddin & Ruvimbo Chidziva, "Civil Society Organisations and Taxation: Emerging Trends and Priorities", *ICTD Blog* (20 November 2020) online: https://perma.cc/KNZ2-E5R5.
Some transnational organizations like the International Consortium of Investigative Journalists (ICIJ) have played a highly significant role in exposing international tax abuse and the role that the subsisting tax regime plays in facilitating such abuses. While such exposes are not directly targeted at addressing inter-nation equity, their existence provokes conversation on whether LIDCs are disproportionately shortchanged by the international tax regime and can, therefore, amplify or accelerate the overall "tax justice" agenda for LIDCs.

[1032] See Orbitax, "Tax Justice Network Africa and Katiba Institute Seek Overturn of 10 Kenyan Tax Treaties", *Orbitax* (24 September 2020) https://www.orbitax.com/news/archive.php/Tax-Justice-Network-Africa-and-43672.

[1033] Thomas Rixen, "Politicization and Institutional (non-)change in International Taxation" (2009) WZB Discussion Paper No. SP IV 2008-306 at 20–21.

[1034] Peters contends that the institutional legitimacy problem in international tax governance can only be addressed by involving non-state actors like NGOs (activist groups like Tax Justice Network, Oxfam, and Christian Aid) in the development of global tax policy. This can engender not just better results but also has "more promising prospectives for the legitimacy (and democratization) of global tax governance". See Cees Peters, Global Tax Justice: Who's Involved?" in Robert F van Brederode, ed, *Ethics and Taxation* (Singapore: Springer, 2020) 165 at 168 and 179 ["Eventually, only involvement of non-state actors will be able to generate spaces for political action 'beyond the state' which have the power to evolve into more democratic forms of global tax governance""].

[1035] Global Alliance for Tax Justice, "Statement: The "Deal of the Rich" will not Benefit Developing Countries" (8 October 2021) online: https://perma.cc/FZ5T-LRT6 ["A solution agreed in a politically biased and opaque process, outside the UN system and the related accountable country representation, cannot have the legitimacy to be a binding international agreement."].

3.6 Chapter Conclusion

This chapter is designated as the main case study of this thesis. My task here has been to evaluate the OECD Pillar One tax compromise from an equity perspective using the RIC framework developed in the preceding chapter. I have undertaken this task, relying on three of the five reasonableness yardsticks hitherto discussed: disparity of means, alternativity, and the potential for non-tax benefits. I found it relatively straightforward to reach a positive conclusion on whether the Pillar One compromise impairs the exercise of tax jurisdiction by LIDCs, as market states. The reasonableness analysis was, expectedly, more complex. There are no simple answers. We must view things on a country-by-country basis and also analyze rule-by-rule. One rule may be highly restrictive for a country while being mostly revenue neutral for another.

Regarding the first test, I conclude that even though the Pillar One compromise attempts to incorporate a disparity of means test into the nexus requirements, that attempt does not go far enough as it is designed in such a way that only the smallest jurisdictions – based only on GDP – are qualified. There is no consideration of the market size/power of countries. This, consequently, leads a large number of LIDCs, including Nigeria and Kenya – who appear to have justifiable revenue grounds for doing so – to consider the deal excessively and unreasonably restrictive on their tax jurisdiction. I conclude that the scoping of Pillar One, streamlined with a global turnover and profitability threshold, might be considered a reasonable policy to the extent that it aims to ensure that only profitable firms can be taxed. However, a global threshold might be considered unreasonable for some countries if it means that an MNE that has nexus there and derives significant revenue there is excluded from taxation because of the global turnover threshold. The rule does not fairly account for the fact that even a globally "small" MNE might have significant economic presence in a country. This factor is especially important for LIDCs

when we consider that many of the big MNEs that Pillar One focuses on may not have much involvement in LIDCs. This nexus rule – coupled with the high global turnover threshold – makes even less sense when one considers that such limitation does not apply with respect to MNEs that operate through a permanent establishment. I mean, no international tax rule requires that an entity of one state that operates in/derives income from another state through a permanent establishment should not be subject to tax in that other state unless the entity's global operations yield a certain turnover and/or profitability. So, there are both neutrality and inter-taxpayer equity concerns here.

On alternativity, I argue that the UN's Article 12B proposal, on many fronts, appears to constitute a more reasonable alternative for LIDCs. The scoping, nexus, and profit allocation rules of Article 12B do not, overall, come close to the OECD Pillar One in restricting the taxing rights of LIDCs; and, importantly, the UN proposal contains inbuilt mechanisms for the elimination of double taxation. I am especially concerned by the lack of proper justification for the arbitrary 25% residual profit allocation. Although economists are split on whether residual profits should be entirely allocated to the market jurisdiction, there are practical implications when they are not. The decision to allocate only 25%, despite the numbers showing that a below 30% allocation would shortchange LIDCs, seems unreasonable, especially when residual profit is itself only a fraction of total profits. It also erodes the efficiency aspect of residual profit allocation which strongly supports market jurisdiction allocation. However, Article 12B is also replete with substantial problems of its own. The want of impact assessment on Article 12B also leaves me unable to conclude that an Article 12B-based regime would significantly improve the tax positions of LIDCs (as mostly small market states). Even then, the potential distortions of a

predominantly gross-based tax on active business income are difficult to ignore. Of course, this assessment should not imply that there can be no suitable alternatives. I offer none here.

Regarding the subject of non-tax benefits, while I am willing to accept, based on available information, that restricted taxation can help digital business models to invest and innovate on the supply side, I have struggled to trace a direct link between restricted market state taxation and increased investment in market states, which would justify the revenue sacrifice that a compromise entails. Nevertheless, I am willing to accept that spillover effects from supply side investment and innovation can accrue to the benefit of market states. Also, the Pillar One thresholds can protect young and, perhaps, not-so-profitable tech-centric enterprises, including those in LIDCs, from problematic cross-border taxation, as they strive to compete overseas. This can overall also mean residence-based taxes for LIDCs.

Despite my various misgivings, including vivid concerns about the political process that produced the Pillar One compromise, I am unable to form a general conclusion that the deal, as a whole, is an unreasonable compromise for LIDC. Important improvements can, of course, be made, as I have highlighted here. However, for specific countries – e.g., Nigeria and Kenya – such a conclusion is reachable, based on the vital economic evaluation provided by Oxfam. As for my general position, I am conscious that Pillar One is a complex political compromise, which means that nobody gets all they want – not even the sometimes parallel-sided rich OECD countries, who, in some cases, had to trade-off something in Pillar One to gain something in Pillar Two, and vice versa. I have laid an evaluative framework. Every sovereign must decide for itself, by reason – not duress – I hope.

Chapter 4: Conclusion

International taxation is a complex entanglement of law, economics, and politics. The subject is deeply political, especially when it comes to the subset of norm making. This is because a substantial portion of the rules that govern international taxation are established by consensus amongst sovereign states. Existing conceptualization of international (tax) relations theory demonstrates that during negotiation, states are largely driven by their individual interests. They are also preoccupied with the motive of balancing different – sometimes conflicting – policy objectives: neutrality, equity, and administrability. As a result, consensus making tends to be bogged down in intricacy and arduousness. Historically, states with more economic-political power tend to dominate both the process and outcome, while non-state actors have been known to project their (usually) commercial interests into the equation. These imperfect alignments sometimes produce outcomes that mismatch different but important policy objectives. Often time, efficiency is prioritized at the expense of equity. The negative distributional effects of such an entrenched rules-based system can be disproportionately felt by states that fall into the low-income, developing, or capital-importing classifications (LIDCs, for convenience).

The negative distributional consequences of our international tax regime agitate the disparate conscience of tax justice advocates and commentators. As a result, there is a rich and robust literature of commentary evaluating the soundness, in inter-national equity terms, of our international tax regime. The work in this field is largely commendable. In many respects it has helped to shore-up inclusivity and equity in the system. Many tax treaties between HIDCs and LIDCs reflect more positive distributional outcomes for the latter and LIDCs can claim to be better seen and heard in contemporary international tax reform endeavors. However, embedded

in that endowed repertoire of equity-centric literature is a troubling narrative that, perhaps, inadvertently casts the case for LIDCs in the mold of aid or charity.

There can be two tracks up the same mountain. This thesis is a modest epistemic attempt at course correction. I demonstrate how the "tax aid" or "charity" narrative can derail/undermine – rather than enhance – the inter-national tax equity agenda for LIDCs. I offer an alternative narrative that is built on a foundation of normative entitlement (tax sovereignty) but that is simultaneously adjustable to inter-national differentiation. This narrative – RIC – emphasizes fiscal self-determination as a pillar of international taxing rights assertion. It builds on the settled notion that sovereign states have an inherent right to tax all taxable factors within their territory. The international tax regime does not grant this entitlement, but can restrict its *exercise*, for various important reasons: principally, the avoidance of double taxation. Ideally, restriction is attained, not by imposition, but by consensus – compromise. However, a state should not be expected to yield to a compromise that restricts the exercise of its tax jurisdiction to an extent that may be adjudged unreasonable, considering that state's peculiar circumstances. A compromise that makes sense, i.e., that is reasonable, for Canada – a country of under 40 million people, GDP of $1.7 trillion and tax-to-GDP ratio of 34% – might not make sense for Nigeria – a country of 200 million people, GDP of $440 billion and tax-to-GDP ratio of under 10%. Nigeria, as a rational state might not be inclined to embrace such a compromise.

While there are no tools to paint an ironclad picture of reasonableness, this thesis offers some useful guidance that can help to make such assessments. My aim is not to offer an evaluative framework that is set in intractable abstraction or "metaphysical speculation". Instead, as I demonstrate, there are many practical examples – some of them familiar – where this framework can be used to evaluate the fairness of international tax regimes, both in respect of our existing

tax treaty framework and in respect of the contemporary compromises that are forging. Therefore, if inter-national tax equity is a high-voltage wire, RIC can help to step it down.

To be clear, international taxation is not without (proposed) schemes that are designed to channel tax aid to LIDCs. However, the narrative around charity-based international tax schemes should neither emasculate nor obfuscate the distinctive portrayal of international tax claims that seek equity by protecting the entitlement of LIDCs to tax their (shared) tax base.

The choice of narratives is not without consequence. As I piece in section 1.3, it obfuscates the distinctiveness of international tax aid and inter-national tax equity, as a discourse. It obscures the conversation around the policy objectives of international tax reform: to make the regime fairer or to distribute aid. It triggers, perhaps, pointless debates about whether there is a cosmopolitan duty of assistance from rich to poor countries and whether the tax system is the avenue to deliver such assistance. It systematically entrenches a "handout" mindset and affords HIDCs a pretext to resist meaningful reform of international tax rules, based on extraneous considerations like corruption and mismanagement in LIDCs and the perceived superior efficacy of their own charitable dispositions. The, sometimes, somewhat red herring infusion of tax aid themes into international tax reform discourse potentially dilutes a more robust articulation of reform that is founded on fiscal entitlement, self-determination, and preservation, as cornerstones of equity; and this can impact negotiating positions. Bringing about conceptual clarity, disambiguation, and evaluative redirection – as I strive to do here – can facilitate an explicit focus on actual tax aid, as reflected in some of the scholarship that truly reflect taxation as a scheme for delivering ODA to LIDCs. It is for these reasons that I am keen to emphasize the imperative for clear articulation of what LIDCs want – or really want – from any engagement

with international tax reform. If it is charity, then we can say so. If it is equitable distribution, there must be some expressive way to draw the line.

Again, I must highlight an aspect of the framing/phrasing of international tax discourse that, I think, perhaps inadvertently, feeds into the charity narrative. It is the notion that the international tax regime – or, more specifically, tax treaties – allocates, distributes, appropriates, or apportions taxing rights. This kind of phrasing – which is most common – entrenches a top-down perception about the origin of taxing rights. In other words, when we use these terms, as we constantly do, we paint the mental picture of a central authority (like in a unitary system of governance) – that devolves taxing rights to states. While such phrasing might be diction convenient, the reality, I must reiterate, is that international tax regimes – as products of compromise, are rather forums for sovereign states – as embodiments of inherent tax jurisdiction – to assume defined obligations to surrender the exercise of taxing rights. The making of such a regime is bottom-up, not top-down. As such, no one allocates, appropriates, or gives taxing rights to LIDCs. It is LIDCs who assume – albeit sometimes in politically compelling circumstances – obligations to give up or surrender *their* taxing rights.

In conclusion, I should stress that this thesis is not without limitations and imperfections. The orbit of international tax reform is circulated by numerous proposals by tax scholars and institutions, e.g., the OECD and the UN, that aim to design a more satisfactory international tax regime. The OECD's Pillar One and the UN's Article 12B – both of which are discussed in the preceding chapter – are some contemporary examples. Such proposals have technical elements, distributional implications and, of course, command varying levels of political acceptability. This thesis, unlike many scholarly attempts in the tax literature, does not propose technical designs for the tax system. Rather, it lays down an underlying normative framework – RIC – for evaluating whether any

technical proposals are equitable, in terms of how they limit the taxing rights of competing jurisdictions. RIC is not itself a technical proposal, in the sense that it does not seek to allocate taxing rights. It is important to highlight this limitation because the thesis does not stop at laying down a normative framework, but also uses that framework to evaluate some of the technical proposals that are in play. Further, I have limited my RIC evaluation to the impairment of source tax jurisdiction. My reason is that source taxation is of greater priority to LIDCs. I have not quite explored how RIC can function in respect of residence-based taxation. I believe that there is scope for further work here.

In the big picture, I may not be the individual best placed to operationalize the framework that I have set out in this work, but I am hopeful that this framework, whatever its limitations, assists in charting a better narrative for LIDCs whenever inter-national tax equity is the subject of conversation. In the end, I do not have all the answers nor command the uncommon sagacity of King Solomon. Yet, like him, I am well sold on leaving every claimant its due.

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