Digital Discord:
Forging Tax Rules to Fit a Digitalized World

Tax Policy & Simplification Committee
ABA Tax Section - May Meeting 2019
May 10, 2019
Wash., D.C.
As business models and transactions become increasingly digitalized, longstanding domestic tax rules, tax treaties, and international tax norms are being challenged in ways that are both unprecedented and fundamental. Unilateral approaches being advanced by tax policy and law makers are disrupting current tax law paradigms; distorting business decisions; and threatening to subject taxpayers and transactions to increasing levels of double tax, tax disputes, and unanticipated costs. The lack of a global consensus on how to tax our increasingly digitalized economies could also leave a confusing patchwork of conflicting tax policies.

The panel will first describe the web of multifaceted tax policy and political issues, and then address specific topics including: the longstanding international tax consensus, forged in the 1920s, on which thousands of tax treaties are based; details of the OECD’s recent “Pillar One” and “Pillar Two” Proposals; an update on various jurisdictions’ unilateral measures; the official US response to these measures (and the possibility of de facto retaliation); how the US Supreme Court’s decision in South Dakota v. Wayfair (2018) fits into this broader international tax debate; and finally, what tax planners and businesses should be doing now to prepare for what could be drastic changes in how businesses and individuals are taxed in our increasingly digitalized world.
Agenda

Introduction and Historical Overview
- “The 1920’s Compromise” – How concepts of Income Source, Residence, Nexus, and Profit Allocation are becoming increasingly anachronistic
- What is the "digital economy"?

Unilateral Initiatives by Nation-States
- India, Italy, Germany, France, US, others
- Discrimination issues; Prohibition on turnover taxes; Impact on US

Multilateral Initiatives
- "BEPS/OECD “ approach v. “EU approach”
- The US perspective
- OECD Pillar 1 Proposals (Three)
  - “User Participation” proposal
  - “Market Intangibles” proposal
  - “Significant Economic Test” proposal
- OECD Pillar 2 Proposals

S. Dakota v. Wayfair - How does US Supreme Court’s decision fit in?
- Constitutional implications
- International tax implications

The Way Forward? Realistic hope for a multilateral approach?

Conclusion - Comments & Q&A
Introduction
and
Historical Overview
Historical Overview
“The 1920’s Compromise”

• In 1921, in wake of World War II, Intern’l Chamber of Commerce & League of Nations set about re-designing an postwar system of international trade. They had a “clean slate” (wiped clean by war).

• The 1928 drafts are recognizable as progenitors of the OECD Model Treaty.

• Debate raged on for 15 years, and in the 1940’s League was debating over 2 models: The Mexican Model (1943), which was thought to favor developing countries through a source-based system, and the London Model, thought to favor developed/industrialized countries through a residence-based tax system.

• The 1964 draft, adopted by predecessor to OECD basically reflected a “compromise” between the Mexican and London models—hence, known as the “1920’s Compromise.”

• For nearly 100 years, the 1920’s Compromise has been the theoretical and economic underpinnings for allocating tax jurisdiction between sovereign Nation-States.
• **Source:** based on an “economic entitlements” theory, which also makes sense under common law. A sovereign country is thought to be naturally and fundamentally entitled to reap the gains within its borders by domestic and foreign-owned factors of production.

• **Residence:** based on in personam jurisdiction. Residence country is entitled to fully tax its legal residents who are presumed to be enjoying the special privileges, rights, and protections afforded to them by the sovereign. Under this theory, the residence country is viewed as the residual or dominant taxing authority.
Anachronistic Principles?
Source, Residence, Nexus, Profit Allocation

• World is now a very different place than in the 1920s when these concepts—source, residence, nexus, and the basis of allocating profits—were embraced.
• But tax treaties based on the OECD Model, and most countries’ tax systems, all require that a distinction be made between “source” and “residence” etc.
• Source of income - Anachronistic? Has become nebulous and no longer relates to realities of how business is conducted. 1920’s business involved tangible goods, which were easier to rationally relate to a particular country. But today, what is “source of income” from e-commerce and digital transactions?
• Residence – also arbitrary? Transnational corporations have member companies all over the world. And individuals are also much more mobile.
• Nexus: Was historically based on physical presence…and profits were allocated to the “permanent establishment” when activities rose to a certain threshold of commercial activity (again often based on physical presence)
Historcial Overview

Digital Discord: the heart of the debate?

- As global business becomes ever more “digital,” an increasing number of policymakers argue that the tax protocols (i.e., nexus, basis for allocating profits, also the validity of using “source” and “residence”) developed in the 1920s is increasingly anachronistic.

- **Heart of the Debate:** belief by some (but certainly not all) countries that there is an unfair mismatch between where profits are currently allocated and taxed AND where digital activities create value.

- **One Key Problem:** Do we yet understand HOW digital activities and digital companies create value? (doubtful…)
What is the “Digital Economy”?

- OECD/G20 Project’s BEPS Action 1: The 2015 report noted that the “digital economy” is characterised:
  - an unparalleled reliance on intangibles
  - Massive use of DATA (notably personal data)
  - Widespread adoption of multi-sided business modesl
  - Also found it would be impossible to “ring fence” the digital economy (its seeping into every aspect of commercial and personal life)

- Robust understanding of how digitalization is changing the way businesses operate and how they create value is KEY to ensuring the tax system responds to these challenges.
Overview: Factors driving today’s debate on taxing the digitalizing economy?
Post-BEPS concerns raised

OECD Interim Report 2018

Scale without mass
Heavy reliance on intangible assets
Data and user participation

Existing profit allocation rules & nexus rules

- Ability to limit local functions and serve market remotely
- Current rules do not grant sufficient taxing rights over intangible property in new settings
- Certain aspects of digitalizing economy, often based on data and users, create under taxed value

Effectiveness of BEPS actions

- DEMPE / Risk
- Avoided PEs
- Treaty access
- Tax competition

While BEPS was effective … not effective enough
Global timeline

BEPS Project Concludes
October 5, 2015
Action 1 Recommendations made

G20 communique
Communique & mandate from Finance Ministers and Leaders – ignites OECD Digital Project

Interim report
March 16, 2018

European
Commission
March 21, 2018
Proposals for DST and long term SDP

European Council
March 2019
Deadline set by France and Germany for agreement on reduced scope

Second Interim report
“Summer 2019”

Updates
January 29, 2019: Update/2-pager
February 13, 2019: Discussion document
March 2019: Public meeting

Final report and recommendations
End 2020

January 1, 2021
Previously proposed start date for EU wide DST

India
June 2016
Equalisation Levy

United States
December 2018
Tax Cuts and Jobs Act

France
January 1, 2019?
Domestic DST in force

Italy
Mid 2019
Domestic DST in force?

United Kingdom
April 1, 2020
Domestic DST in force

European Union
January 1, 2021
Previously proposed start date for EU wide DST

India
April 2019
Significant Economic Presence

United States
December 2018
Tax Cuts and Jobs Act

France
January 1, 2019?
Domestic DST in force

Italy
Mid 2019
Domestic DST in force?
“Unilateral” Initiatives by Nation-States (and EU)
**Unilateral measures – Big Picture**

- Modification of PE definition
- Turnover tax/ Withholding tax
- BEAT/ GILTI

*Non-exhaustive overview. Some measures are proposed and have not yet been formally introduced.*
“Non-turnover-based” Unilateral Measures: Virtual/digital PEs and significant economic presence

<table>
<thead>
<tr>
<th>European Union</th>
<th>India</th>
<th>Italy</th>
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</thead>
<tbody>
<tr>
<td>• Directive on significant digital presence (i.e. digital PE)</td>
<td>• New threshold introduced under Finance Act 2018</td>
<td>• New threshold introduced under Finance Act 2018</td>
</tr>
<tr>
<td>• Threshold</td>
<td>• Threshold</td>
<td>• Threshold and scope</td>
</tr>
<tr>
<td>- 3000 contracts; or</td>
<td>- Revenues from physical goods/services (TBC)</td>
<td>- “A significant and continuous economic presence in the territory of the State set up in a way that it does not result in a substantial physical presence in the same territory”</td>
</tr>
<tr>
<td>- 100,000 users; or</td>
<td>- Revenues from digital goods/services (TBC)</td>
<td>• Basis</td>
</tr>
<tr>
<td>- €7m revenues in a Member State</td>
<td>- Number of users (TBC)</td>
<td>- No change from previous application; OECD TPG</td>
</tr>
<tr>
<td>• Scope</td>
<td>• Scope and Basis</td>
<td>• Application</td>
</tr>
<tr>
<td>- Broad – almost all digitally supplied services, except specific exemptions</td>
<td>- Broad – income from India (from services above) deemed to arise in India</td>
<td>- From January 1, 2019</td>
</tr>
<tr>
<td>• Basis</td>
<td>• Application</td>
<td>• Status: in force</td>
</tr>
<tr>
<td>- Income allocated by profit split on destination favourable factors</td>
<td>- From April 1, 2019</td>
<td>• Only applicable where no relevant bilateral tax treaty</td>
</tr>
<tr>
<td>• Application</td>
<td>• Status: comes into force on April 1, 2019; guidance expected on detail imminently (following consultation in 2018)</td>
<td></td>
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<tr>
<td>- From January 1, 2020</td>
<td></td>
<td></td>
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<tr>
<td>• Status: under negotiation (although not currently being focused on)</td>
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• Only applicable where no relevant bilateral tax treaty
## Turnover-based Unilateral Measures: Equalization levies and digital service taxes (DSTs)

<table>
<thead>
<tr>
<th>India</th>
<th>European Union</th>
</tr>
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</table>
| • Indian Finance Act 2016  
  • Threshold  
    - Online advertising supplied to Indian residents by non-Indian residents  
  • Scope  
    - Online advertising services  
  • Basis  
    - Gross revenues, tax to be withheld and remitted by the payer  
  • Rate  
    - 6%  
  • Application  
    - From June 1, 2016  
  • **Status: In force** | • Directive for a common digital services tax (DST)  
  • Threshold  
    - €750m global turnover, with >€50m from EU  
  • Scope  
    - Advertising  
    - Intermediation of Platforms  
    - Transmission of User Data  
  • Basis  
    - Where user (rather than payer or payee) is located  
  • Rate  
    - 3%  
  • Application  
    - From January 2020  
    - From January 1, 2021  
    - Sunset clause – 2025, or OECD or EU agreement |
## Turnover-based Unilateral Measures: Digital service taxes and equalization levies

### France, Italy, Austria
- Local law intended to introduce European Commission’s original proposals (following no agreement at EU level).
- **Threshold**
  - €750m global turnover
  - >€3m from Austria
  - >€25m from France
- **Scope**
  - Advertising (Austria, France, Italy)
  - Intermediation platforms (France, Italy)
  - Transmission of user data (France, Italy)
- **Basis**
  - Where user (rather than payer or payee) is located
- **Rate**
  - 3%
- **Application**
  - From January 1, 2019 (France), mid-2019 (Italy), TBC (Austria)
- **Status**: Enacting legislation/detail not yet available in any country; above based on original EC proposal

### United Kingdom
- Local law announced in advance of EU negotiations reaching initial conclusions. Tax based on user participation.
- **Threshold**
  - £500m global turnover, with >£25m from in scope, UK activities
- **Scope**
  - Search engines
  - Social media
  - Online marketplaces
- **Basis**
  - Direct or indirect revenues from activities in scope relating to UK users
- **Rate**
  - 2%
  - Safe harbour for low margin businesses (unclear how this margin/profitability will be calculated)
- **Application**
  - From April 1, 2020
EU’s unilateral measures

March 2018
- UK: Position Paper
- Commission: Proposal
  - Spain?
  - Italy: Legislation

December 2018
- UK: Consultation
- France: In Force?
- Reduced Scope Proposal
  - Abandoned
  - Italy: In Force?

March 2019
- France: Legislation

January 2020
- Austria: In Force?

April 2020
- UK: In Force
Recent unilateral measures

### Non-turnover based

<table>
<thead>
<tr>
<th>Measure:</th>
<th>Rate:</th>
<th>Effective from:</th>
<th>Countries:</th>
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<tbody>
<tr>
<td>DPT</td>
<td>25% / 40%</td>
<td>2015, 2017</td>
<td>United Kingdom, Australia</td>
</tr>
<tr>
<td>Virtual PE</td>
<td>28% / TBC</td>
<td>2019, TBC</td>
<td>Italy, Korea</td>
</tr>
<tr>
<td>Novel new source / deeming provisions</td>
<td>20% / CT rates</td>
<td>2017 / 2018 / 2019</td>
<td>United Kingdom, Hong Kong, Taiwan</td>
</tr>
<tr>
<td>Significant Economic Presence</td>
<td>CT rates</td>
<td>2019</td>
<td>India</td>
</tr>
</tbody>
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### Turnover based

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<th>Measure:</th>
<th>Rate:</th>
<th>Effective from:</th>
<th>Countries:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equalisation Levy</td>
<td>6% / 5% / 10%</td>
<td>2016, 2019, TBC</td>
<td>India, Pakistan, Chile</td>
</tr>
<tr>
<td>VAT / Sales Tax</td>
<td>Various</td>
<td>2016, 2017, 2018, 2019</td>
<td>Russia, Israel, Saudi, Canada</td>
</tr>
<tr>
<td>Digital Services Tax</td>
<td>3% / 3% / 2% / 3%</td>
<td>2019, 2019, 2020, TBC</td>
<td>France, Austria, Italy, United Kingdom, Spain*</td>
</tr>
<tr>
<td>Digital Services / Advertising Tax**</td>
<td>3%</td>
<td>TBC</td>
<td>European Union</td>
</tr>
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*Budget voted down – awaiting General Election

** Vote cancelled in March 2019 – may re-emerge from new Parliament and Commission in H2 2019
U.S. Reaction to National Initiatives

  - Concerns about unilateral DSTs, which are “designed to discriminate against U.S.-based multinational companies.”
  - “It is important that you make clear to the representatives of these countries the need to abandon unilateral actions and work through the multilateral process at the [OECD].”
  - Cited progress evidenced by OECD 29 Jan note
Treasury Dep. Asst Sec’y for Int’l Tax Affairs Harter comments of 12 March

- French proposal could be challenged as discriminatory vis-à-vis US companies under the WTO, trade agreements, and treaties (no mention of IRC sec 891)
- “The U.S. is opposed to any digital services tax proposals…. [U]ser participation is just not a sound basis for taxing companies….”
- “users are unrelated parties and…their input is purchased on barter basis [for] a free service.”
“The U.S. firmly opposes proposals by any country to single out digital companies. Some of these companies are among the greatest contributors to U.S. job creation and economic growth. Imposing new and redundant tax burdens would inhibit growth and ultimately harm workers and consumers. I fully support international cooperation to address broader tax challenges arising from the modern economy and to put the international tax system on a more sustainable footing.”

Secretary of the Treasury Steven Mnuchin (March 16, 2019)
Multilateral Initiatives
Post-BEPS concerns raised

<table>
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<th>Heavy reliance on intangible assets</th>
<th>Data and user participation</th>
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<th>Existing profit allocation rules &amp; nexus rules</th>
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<td>Ability to limit local functions and serve market remotely</td>
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<td>Current rules do not grant sufficient taxing rights over intangible property in new settings</td>
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<td>Certain aspects of digitalizing economy, often based on data and users, create under taxed value</td>
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<th>Effectiveness of BEPS actions</th>
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<tr>
<td>DEMPE / Risk</td>
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<tr>
<td>Avoided PEs</td>
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<tr>
<td>Treaty access</td>
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<tr>
<td>Tax competition</td>
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While BEPS was effective … not effective enough
### OECD Public Consultation: An Overview

#### Pillar 1
**Broader challenges of digitalized economy and allocation of taxing rights**
- Where should taxes be paid (nexus / allocation of taxing rights)?
- How can profits be allocated to be locally taxed (profit attribution)?
- Attempt to avoid uncoordinated unilateral action

#### Proposals (beyond the arm’s length principle):
1. “user participation”
2. “marketing intangibles”
3. “significant economic presence”

#### Pillar 2
**Remaining BEPS Issues: Base erosion and profit-shifting**
- How could, in particular, the risk of profit-shifting be addressed?
- Attempt to avoid uncoordinated unilateral action

#### Proposal:
1. “income inclusion rule” combined with
2. “tax on base eroding payments”

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- Interim Report 2018
- BEPS Inclusive Framework, BEPS Action 1
2 anti-base erosion proposals

- Both recall harmful tax competition concern
- Income inclusion proposal
  - Policies of the GILTI regime (min tax on CFCs)
- Low-tax proposal
  - From the standpoint of hybridity being only one form of tax arbitrage; US’s own anti-hybrid regs are lacking just as Action 2.
  - This though would be very complicated (ETR + imported mismatch rules for all payments etc)
Pillar 1: Revised profit allocation and nexus rules

A) User Participation

- Developed by UK; Key DST idea
- Social media, search engines, online marketplaces

B) Marketing Intangibles

- Getting very serious consideration; US is major proponent
- Intent is to reallocate some income to destination jurisdiction. Simplified/formulaic (non-ALS) approaches being considered

C) Significant Economic Presence

- Reduced nexus threshold plus formula apportionment; India + G24
- Lowers nexus threshold; formula apportionment of unitary/group wide income
OECD Update 2019
Key points and immediate timetable

“The digitalization of the economy is pervasive, raises broader issues, and is most evident in, but not limited to, highly digitalized businesses”

The proposals may go beyond the arm's length principle and also consider innovative types of nexus that would not require a physical presence.
OECD Pillar I
Proposal A

“User Participation” Test
“User participation”

- Gives more taxing rights to user jurisdictions
- Limited scope: social media platforms / search engines / online marketplaces
- Nexus based on (valuable) user participation
- Non-routine / residual profit split approach (beyond arm’s length principle) to determine value created by users, i.e., current rules would continue to be used for determination of profits connected to routine functions
- Formula based determination of user value
- Strong dispute resolution component
- Critics: Value creation by business or by third parties (users)? Relevance beyond highly digitalized businesses? Sustainable solution? ...
Pillar 1: Revised profit allocation and nexus rules:  
(A) User Participation

Rationale

• Activities and participation of “users” are a critical component of value creation, both absolutely and relatively
• This is only true for certain highly digitalised businesses

Business models in scope

• Social media
• Search engines
• Online marketplaces

Proposed methodology

• Calculate “residual” profits
• Attribute portion of residual to “user base”
• Allocate between jurisdictions where users are located
• Give rights to jurisdictions to tax these profits
OECD Pillar I
Proposal B

“Market Intangibles” Test
Pillar 1: Revised profit allocation and nexus rules

(B) Marketing intangibles

Rationale

- Remote / limited access to markets can allow for development of large customer bases / user bases
- Customer data and relationships contribute to brand / marketing intangibles (more than favourable demand conditions alone)
- Distinction between “trade” and “marketing” intangibles

Option 1

- Update transfer pricing rules to recognise “marketing” intangibles (and risks) separate to “trade” intangibles
- Allocate to “market” jurisdiction based on agreed metrics (e.g. revenues or users)

Option 2

- Undertake a residual profit split (functional or formulaic) following allocation of routine functions
- Allocate to “market” jurisdiction based on agreed metrics (e.g. revenues or users)
Pillar 1: Revised profit allocation and nexus rules

(B) “Marketing Intangibles”

- Gives more taxing rights to market jurisdictions
- Wider scope than the user participation approach (intrinsic functional link between marketing intangibles and a market jurisdiction)
- Nexus based on marketing intangibles allocated to market jurisdictions:
  - Activity in a market jurisdiction without taxable presence would become taxable based on non-routine income
  - LRD-structures (highly digitalized and consumer product businesses) would be taxed on a broader tax basis
- Non-routine income connected with marketing intangibles and attendant risks, i.e., current rules would continue to be used for determination of profits connected to routine functions
OECD Public Consultation – Pillar 1 (cont.)

- Fractional apportionment method:
  - Tax base (global profit rate of the MNE group)
  - Allocation keys (sales, assets, employees, user in specific businesses)
  - Weighing

- Modified deemed profits methods
Attribution of income irrespective of the legal owner in the group, of the execution of the DEMPE functions or the risk-relations according to the current TP rules

Allocation methods:
- Application of the transactional TP rules (determination of the marketing intangibles and the allocated profit under two assumptions)
- Revised residual (non-routine) profit split analysis and application to the market jurisdictions

Marketing intangibles (remotely controlled, e.g., by usage of a LRD or a limited physical presence (online retailer)) vs. trade intangibles; DEMPE functions could be avoided in the market jurisdiction

Critics: Intrinsic link given, e.g., in case of not significantly local user-tailored marketing? B2B vs. B2C? ...
OECD Public Consultation (cont.)

- Pillars influenced by US marketing intangible proposal and GILTI
  - And see remarks of Treasury Dep. Asst Sec’y for Int’l Tax Affairs Harter above

- Johnson & Johnson letter per OECD Consultation for mkt country return:
  - Marketing intangible proposal would be complicated leading to disputes re system profit/routine returns/residual profit from marketing intangible/apportionment
OECD Public Consultation (cont.)

- Instead: market country share from Local Mkt Distributor (deemed if digital):
  - Base return of a % of ROS
  - Adjusted up/down for high/low oper. Margin
  - Adjusted up/down for targeted marketing spend above/below a certain % of sales
  - Capped at a % of group business line profit
  - Functions not part of mktg/sales/distribution would remain outside this regime.
OECD Pillar I
Proposal C

“Significant Economic Presence”
OECD Public Consultation – Pillar 1

(C) “Significant Economic Presence”

- **“Significant economic presence”** (also see Action 1 report)
  - Reconsideration of existing nexus concepts (see also Supreme Court Decision 21 June 2018: South Dakota v. Wayfair, Inc., 17-494)

- (Cumulative / alternative) Factor-approach, e.g.,
  - Existing user base and associated data input
  - Volume of digital content derived from a relevant jurisdiction
  - Billing and collection in local currency or with local form of payment
  - Maintenance of a website in a local language
  - Responsibility of the final delivery of the goods to customers or the provision by the enterprise of other support services (after-sales, repairs, maintenance)
  - Sustained marketing and sales promotion activities to attract customers

- Thresholds? Types of transactions covered?
Pillar 1: Revised profit allocation and nexus rules: (C) Significant Economic Presence

Rationale

- Similar to (B), would apply to all businesses considered to be generating value from interactions with customers/users
- However, intended to be simpler to apply for developing countries, and would thus be closer to global formulary apportionment in practice

Nexus: Revenue + (one or more of...)

- Users
- Volume of digital content derived
- Billing/collection currency
- Local payment systems
- Local language website
- Sustained marketing activities

Allocation: Fractional apportionment

- Define tax base to be divided (e.g. global profit margin * local sales)
- Use **weighted** allocation keys (e.g. users sales, assets, employees...)

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**Note:**

- Text in italics indicates key concepts or terms.
- Text in bold highlights important points or definitions.
- Text in **italics** or **bold** may be used to emphasize specific details or clarify complex points.
OECD’s “Significant Economic Presence” Test


- Taxable presence in a country on the basis of factors that evidence a purposeful and sustained interaction with the economy of that country via technology and other automated tools

- Factors: Revenue generated on a sustained basis + Users / Volume of digital content derived / Billing/collection currency / sustained marketing activities, etc.

- Profit allocation to SEP on fractional apportionment method

- Aiming for a simplified solution
Significant Economic Presence: India

- 2017 Update to OECD Model Tax Convention - India reserved right to include in Article 5 a SEP test (based on criteria identified in BEPS Action 1 Report 2015) will for establishing a permanent establishment

- 2018 Finance Act - Introduction of SEP by expanding definition of ‘business connection’ under Indian law, to be effective April 1, 2019

- SEP means –
  - transactions in respect of any goods, services or property, including download of data or software
  - systematic and continuous soliciting of business or engaging in interaction with users

- Threshold – Revenue, number of users - Not yet notified

- Not applicable in a treaty scenario unless Article 5 of India’s treaties are modified

- Proposed amendment to PE profit attribution rules - apportioning profits on basis of four factors of sales, employees, asset and **users** (different weightage for low / medium user intensity v. high user intensity)

- Temporary measure until global consensus?
OECD Pillar 2

The “Base Erosion” Proposal and Minimum Tax
Tax and the digitalization of the economy
Pillar 2: Global anti-base erosion proposal

Rationale

- Existing BEPS rules do not provide comprehensive solution to risk of moving profits to low/no tax jurisdictions
- Particular concern in relation to intangibles (which are prevalent in highly digitalised businesses, among others)

Income inclusion rule

- Minimum taxation at shareholder level for significant direct / indirect ownership
- Foreign branch exemptions “switched” off if minimum tax not met
- Supplement (not replace) existing CFC rules
- EU could implement via Directive

Tax on base-eroding payments

- Denial of deduction for certain payments to related parties (common ownership) not subject to a minimum effective taxation by recipient
- Treaty benefit restriction where payments were “undertaxed” (limiting the application of Articles 7, 9, 10, 11-13 and 21) – some of which may also apply for third parties
Pillar 2: Global anti-base erosion proposal (cont. 1)

- **Rational for proposal**: While BEPS measure further “aligned taxation with value creation, and closed gaps that allowed for double taxation, BEPS has not provided a comprehensive solution to …structure that shift profit to entities w/no or very low taxation. Concern about global “race to the bottom” and other countries’ tax bases in general…

- Proposal is *not limited* to highly digitalized businesses.

- Proposal is broadly systemic, and designed to ensure that ALL internationally operating businesses pay a minimum level of tax.

- Proposal does not tolerate the allocation of a high level of risk-related returns to jurisdictions where there is really only a “modest” level of substance.
Tax and the digitalization of the economy

**Pillar 2: Global anti-base erosion proposal**

*(cont. 2) A two-part inter-related proposed rule*

- **Income inclusion rule:** would tax the income of a foreign branch or a 25% controlled entity IF that income was subject to a low effective tax rate in the jurisdiction or “establishment or residence.”
  - Would supplement, not replace, countries’ CFC rules
  - Commanders criticized entire concept as being too complicated, and aimed at same thing BEPS provisions are aimed at. Also, 25% threshold would conflict with most countries’ CFC rules (with use > 50%).

- **Tax on base eroding payments:** would deny a deduction or treaty relief for certain payments unless that payment was subject to an ETR at or above a minimum.
  - “Undertaxed payments rule” would deny dds for paymts to related party if below minimum rate
  - “Subject-to-Tax rule” in tax treaties would grant certain treaty benefits only if the item of income is sufficiently taxed in the other state. (like Action 2 hybrid rules….but focused on the rate?)
Pros, Cons, and Criticisms

- **Pros:** Could provide “full lifetime employment to international tax lawyers” given its inherent complexity—i.e., global GILTI rule + a global BEAT rule

- **Cons:**
  - *Represents real infringement on national sovereignty* (Countries should be able to choose their corporate tax rate to support their own needs, infrastructure.)
  - *Extremely complex in application,* and yet does not appear sufficiently tailored to its stated purposes (i.e., to address risk of profit shifting to entities subject to no or low taxation).
  - *Would target genuine investments* that lead to real economic activity
  - *Could create real barriers to trade* where payments represent real economic costs and are made to real biz operations
  - *Distortive behavioral economic effects* of establishing a “one-size-fits-all” global minimum rate (especially when it is imposed country-by-country)
  - *Overly broad:* proposal goes way beyond targeting
South Dakota v. Wayfair

How does US Supreme Court’s decision fit in?
Wayfair and Beyond

Allan Erbsen
May 10, 2019
Questions about *Wayfair*:

1. Why is the constitutional issue difficult?

2. What types of constitutional arguments are available to challenge state sales taxes?

3. What constitutional questions about sales taxes did *Wayfair* leave open?

4. Is *Wayfair* relevant in other contexts (including, to pick a random topic, taxation of digital income)?
Factors that complicate constitutional analysis of sales taxes:

1. Mismatch between political and market borders
2. Indeterminate physical location of economic activity
3. Diversity of tax regimes among and within states
4. Risk of disproportionate tax burdens
5. Administrability, avoidance, and evasion
6. Vague constitutional text
Typology of constitutional objections in horizontal federalism (including tax) cases:

1. Capacity (lack of sovereignty/power)

2. Constraint (infringement of a right)

3. Centralization (intrusion on national prerogative)
Open constitutional questions about sales taxes after *Wayfair*:

1. Can merchants raise new challenges to sales tax obligations?
   
a. The taxing state is not a member of the SSUTA?

b. Very small businesses that nevertheless meet the $100,000 or 200 sales thresholds?

c. Low sales in large markets (NY rather than SD)?

2. Is jurisdiction to impose collection obligations coextensive with adjudicative jurisdiction over the collector?
Translating *Wayfair* into other contexts:

1. Income taxes (including on trusts: *see North Carolina v. Kaestner*, pending in SCOTUS)?
   a. What is the constitutional test?
   b. Formal distinctions v. functional analysis?

2. Beyond domestic constitutional law?

   Did the Court make sensible policy arguments or technical constitutional holdings? And what is the difference?
The Way Forward?

Is there a realistic hope for a multilateral approach?
# OECD Public Consultation: Next Steps

<table>
<thead>
<tr>
<th>When?</th>
<th>What?</th>
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<tr>
<td>8/9 April 2019</td>
<td>Meeting of the steering group of the Inclusive Framework</td>
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<td>12-14 April 2019</td>
<td>Spring Meetings of the World Bank Group and the International Monetary Fund (G20 finance ministers)</td>
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<tr>
<td>28/29 May 2019</td>
<td>Meeting of the Steering Group of the Inclusive Framework (technical working plan for the working parties 1, 6 and 11 of the Committee on Fiscal Affairs)</td>
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<td>22/23 May 2019</td>
<td>2019 Ministerial Council Meeting</td>
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<tr>
<td>8/9 June 2019</td>
<td>G20 Finance Ministers and Central Bank Governors Meeting to present the working plan to start the technical work</td>
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<tr>
<td>28/29 June 2019</td>
<td>G20 Summit Japan to present the working plan</td>
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<td>Until 2020</td>
<td>Technical work</td>
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<td>tbd</td>
<td>Further consultation of the stakeholders</td>
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<td>By the end of 2020</td>
<td>Global consensus based solution</td>
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Concluding Remarks

Audience Comments

and

Q&A
Thank You

• **Moderator:** Pamela A. Fuller, Royse Law Firm, New York, NY; Tully Rinckey, PLLC, New York, NY

• **Speaker:** Peter H. Blessing, IRS Associate Chief Counsel (International)

• **Speaker:** Allan Erbsen, Professor, U. of Minnesota Law School, Minneapolis, MN

• **Speaker:** Brian Jenn, Deputy International Tax Counsel, Office of Tax Policy, U.S. Treasury Dept.; Co-Chair of OECD Task Force on the Digital Economy

• **Speaker:** Will Morris, Dep. Global Tax Policy Leader, PwC, Wash. DC; Chair, Business at OECD (BIAC)

• **Speaker:** Mansi Seth, Dechert LLP, New York, NY
Peter H. Blessing

- Peter H. Blessing was recently appointed “Associate Chief Counsel (International)” at the Internal Revenue Service, based in Washington, D.C. He began his new job this week, after many years in private tax law practice.

- Just prior to his appointment to the IRS’ Chief Counsel’s Office, Peter served as a member of the International Tax and Complex Transactions Group within the Washington National Tax practice at KPMG LLP.

- Over this career, Peter has developed a reputation as one of the leading international tax advisors, with broad experience in the major areas of cross-border taxation. His practice involves transactional, advisory and controversy matters, generally in a cross-border context. A central part of his practice involves advising clients on structuring cross-border property, (REIT and non-REIT) private equity, and hedge fund investments, including financings, acquisitions and dispositions, and treaty planning. Prior to joining KPMG Peter was a partner at a major Wall Street law firm for over 25 years.

- Peter’s publications and speaking engagements include editor and a co-author of Tax Planning for International Mergers, Acquisitions, Joint Ventures and Restructurings (Kluwer). Peter also authored a treatise, Income Tax Treaties of the United States (Warren Gorham & Lamont). He is a frequent lecturer on various aspects of taxation and cross-border taxation at seminars sponsored by TEI, PLI, IFA, IBA, ABA, NYSBA, NYU, GW-IRS, California State Bar, USC Tax institute, Canadian Tax Foundation, and others.

- Peter’s professional associations include the American Bar Association Tax Section - Vice Chair, Government Relations; International Fiscal Association USA Branch - President-elect; New York State Bar Association Tax Section - Chair 2010; International Bar Association Taxes Committee - Chair 2011; and the International Tax Institute – President 2003-05.

- Peter Blessing received his LL.M in Taxation from New York University School of Law, JD from Columbia University Law School and BA from Princeton University.
Allan Erbsen
Professor of Law
University of Minnesota Law School

Professor Erbsen received an A.B. from Harvard College and a J.D. from Harvard Law School, where he was Articles Chair of the *Harvard Law Review*. He was a law clerk for Judge Judith Rogers of the United States Court of Appeals for the D.C. Circuit and spent six years in private practice at Mayer, Brown & Platt in Chicago and Wilmer, Cutler, & Pickering in Washington, D.C. He has been a fellow at Vanderbilt Law School and a Visiting Associate Professor at Georgetown University Law Center. Professor Erbsen is a member of the American Law Institute and a past chair of the Association of American Law Schools Section on Civil Procedure. At the University of Minnesota, he has been Acting Dean, Associate Dean, and the Stanley V. Kinyon Teacher of the Year.
Ms. Fuller advises a wide range of clients—including private and public companies, joint ventures, private equity funds, individuals, C-Suite executives, “start-ups,” and government entities—on transactional, investment, and supply-chain strategies to achieve optimal tax and business results. As a seasoned practitioner and tax technician, Ms. Fuller is accustomed to handling nuanced matters involving highly technical questions of law, policy, and procedure at the federal, state, local, and international levels. She provides sophisticated tax planning services across most industry sectors, including software & emerging digital technologies, financial services, real estate development, healthcare, pharmaceutical, construction & engineering, infrastructure, oil & energy, and retail.

Ms. Fuller is also an effective taxpayer advocate, with two decades of experience resolving U.S. federal, state, and foreign tax controversies, as well as asserted tax penalties. Some of the controversies Ms. Fuller has handled have involved novel questions of law. She also has significant experience with complex transfer pricing issues—skills she first acquired while clerking for the United States Tax Court, serving three consecutive 2-year terms as Attorney Advisor to that court’s Chief Judge immediately following graduation with her Juris Doctorate (U.S.) degree.

Ms. Fuller holds an LL.M. in Tax Law from New York University School of Law, where she served as Graduate Editor of that school’s international law review and completed post-LL.M. studies in international business and comparative law; a J.D. from Seattle University; and a B.A. from the University of Washington. She is admitted to practice law in several U.S. state jurisdictions and multiple federal courts, including the U.S. Tax Court.

Prior to becoming an attorney, Ms. Fuller was a business news reporter and an all-news radio anchor for a highly regarded NBC News affiliate in Seattle, Washington, covering regional, national, and transnational business and geo-political developments.
Brian H. Jenn

- Deputy International Tax Counsel
  U.S. Department of the Treasury
  Washington, DC, USA

- Co-Chair of OECD Task Force on the Digital Economy
  Organisation of Economic Co-Operation and Development

Mr. Jenn joined the Office of the International Tax Counsel in the Treasury Department's Office of Tax Policy in January 2012. At Treasury, he focuses on a wide range of international tax legal and policy issues, including subpart F, foreign currency issues, transfer pricing, digital economy and cloud issues, and cross-border reorganizations. He is a U.S. Treasury delegate to OECD’s Working Party 6 on Transfer Pricing, which has responsibility for the development of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, and is Co-Chair of the OECD’s Task Force on the Digital Economy.

Mr. Jenn earned his B.A. and M.A. (Economics) at Northwestern University and his J.D. at Yale Law School. Prior to joining Treasury, Mr. Jenn worked on international tax issues at a law firm in Washington, DC, and served at the Council of Economic Advisers (2001-2003) and in the U.S. Senate on the Chairman’s staff of the Joint Economic Committee (2003-2004).
William H. Morris

Deputy Global Tax Policy Leader
PwC

Will Morris is currently Deputy Global Tax Policy Leader at PwC, based in London and Washington DC. Will has degrees in history, law, and theology from Trinity College Cambridge, the University of Virginia, and St Mellitus College, respectively.

After private practice in London and Washington, DC, he joined the IRS in 1995, moving to the Office of Tax Policy at the US Treasury in January 1997 to work on international tax policy. Will was Associate International Tax Counsel until March 2000, when he joined GE, first in Fairfield CT., then London, where he coordinated GE’s global tax policy program.

Will was appointed Chair of the BIAC Tax Committee to the OECD in November 2012, is also Chair of the AmCham EU Tax Committee, and was CBI Tax Committee Chair from 2010-16. He chairs the European Tax Policy Forum (ETPF), a registered UK charity that since 2005 has commissioned 50 papers from leading academic economists into business tax issues.
Mansi Seth, Esq.

Mansi Seth is a member of the tax group at Dechert LLP. Her practice involves advising on international tax matters. Prior to joining Dechert, Ms. Seth practiced at Nishith Desai Associates, an international Indian law firm, as the co-leader of their international tax group and head of their U.S. tax practice.

Ms. Seth is qualified to practice law in India and New York, and received her Master of Laws degree in Taxation from Georgetown University (Washington DC).

Ms. Seth has presented at conferences for numerous organizations, such as the International Bar Association, Emerging Markets Private Equity Association, AIJA, TiE New York and Foundation of International Tax and has written on tax law in India for multiple publications. She has been the recipient of the Tax Section scholarship of the International Bar Association.