A New Global Tax Deal for the Digital Age

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PRÉCIS
L’Organisation de coopération et de développement économiques (OCDE) est engagée dans un projet visant à relever les défis fiscaux liés à la numérisation de l’économie. Tel qu’énoncé initialement dans son programme de travail publié en mai 2019, l’objectif est de parvenir à un consensus sur un nouveau droit d’imposition qui permettrait aux pays d’imposer les multinationales même en l’absence d’une présence physique traditionnelle. Dans cet article, les auteurs soutiennent qu’après examen, le plan semble surtout axé sur le rééquilibrage des droits d’imposition, principalement dans un certain nombre d’États membres de l’OCDE et quelques autres États clés non membres, et que, de ce point de vue, l’effort urgent mené pour conclure une nouvelle entente fiscale mondiale à l’ère numérique risque de reporter à un moment non précisé un débat fort nécessaire sur les implications plus vastes de distribution de l’entente fiscale mondiale actuelle. La première partie de l’article présente un aperçu de certains des principaux facteurs qui ont incité l’OCDE à se pencher sur ce sujet. La deuxième partie examine les origines et l’évolution du lien dans le régime fiscal international, montrant pourquoi ce concept se prête à une large expansion. La troisième partie porte sur l’éventail des réformes actuellement à l’étude, soutenant que l’accent mis sur la numérisation fait oublier le lien que l’on devrait faire avec d’autres programmes de politiques urgents à l’échelle internationale également en cours d’élaboration, notamment un engagement mondial à créer des institutions qui soutiennent le développement économique durable. L’article se termine par une prédiction selon laquelle, suivant sa trajectoire actuelle, le programme de travail sur la numérisation produira probablement une nouvelle entente fiscale mondiale ressemblant beaucoup à l’ancienne, avec une redistribution relativement modeste des droits d’imposition entre quelques États clés, manquant ainsi l’occasion d’entreprendre une véritable réforme.

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ABSTRACT
The Organisation for Economic Co-operation and Development (OECD) is in the midst of a project intended to tackle the tax challenges arising from the digitalization of the economy. As initially laid out in its program of work released in May 2019, the goal is to develop consensus on a new taxing right that would allow countries to tax multinationals even in the absence of traditional physical presence. In this paper, the authors argue that upon inspection, the plan seems primarily focused on rebalancing taxing rights mostly among a number of OECD member states plus a few other key non-OECD states, and that, viewed from this perspective, the urgent effort to forge a new global tax deal for the digital age risks deferring a much-needed discussion on the broader distributive implications of the current global tax deal to some unspecified future time. The first part of the paper offers a brief survey of some of the main factors that prompted the OECD to turn its attention to this topic. The second part considers the origins and development of nexus in the international tax regime, showing why this concept is amenable to broad expansion. The third part examines the range of reforms currently under consideration, arguing that the framing on digitalization misses a necessary connection to other pressing international policy programs that are also under development, most notably a global commitment to building institutions that support sustainable economic development. The paper concludes with a prediction that on its current trajectory, the program of work on digitalization is likely to produce a new global tax deal that looks much like the old global tax deal, with a relatively modest redistribution of taxing rights among a few key states, thus missing an opportunity for meaningful reform.

KEYWORDS: TAXATION ■ DIGITALIZATION ■ OECD ■ USERS ■ ECONOMIC PRESENCE ■ INTANGIBLES

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INTRODUCTION
The international tax community is currently focused on an urgent tax policy priority, namely, tackling the tax challenges arising from the digitalization of the economy. The urgency arises, according to a series of international policy documents,1 because multinational firms are increasingly able to access local consumers using digital platforms that avoid the customary thresholds to taxation, thus preventing some states from collecting their desired share of the global tax base. The response of the Organisation for Economic Co-operation and Development (OECD) is to initiate a coordinated global movement to adjust the organizing norms of the international tax regime to this new economic reality. As set out in pillar 1 of the 2019 OECD work program, the goal is to develop consensus on a new taxing right, which would take shape in one of three proposals based on the concepts of user participation, marketing intangibles, substantive economic presence, or a combination of them.2

Using the language of new taxing rights signals a rare opening of the discourse around well-established traditions. The OECD expressly seeks not only rule changes that are expected to alter the distribution of current taxing rights among states, but also justified rationales that would explain why these expected distributive impacts

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2 As defined and discussed more fully below.
should be broadly accepted. Since this discussion takes place against the backdrop of conventional residence- and source-state designations, the 2019 OECD work program appears to take seriously some longstanding complaints about the division of taxing rights between states that take the role of both residence and source (most of which are OECD members) and those that mostly take the role of the source state (most of which are non-members). A closer inspection, however, reveals that the work program takes a narrower focus, separating source states into subcategories in order to focus on what the OECD calls “market jurisdictions”—namely, states in which significant numbers of digital service users, customers, or consumers are located.3

While virtually every population in the world has some digital service users, the major market jurisdictions are mostly OECD member states, with the United States and Europe taking their usual roles at the centre of policy-making attention, in addition to some very prominent states outside the OECD membership—notably China and India, and to a lesser extent Brazil. In proposing to alter nexus and profit allocation to benefit market jurisdictions, the 2019 OECD work program does not seek to examine the balance between residence and source taxation after all. Instead it seems to be about rebalancing taxing rights—mostly among the relatively affluent OECD member states plus a few other key non-OECD states—while otherwise freezing for the foreseeable future the current consensus on the general division of taxing rights between residence and source states.

Viewed from this perspective, the international tax community’s urgent effort to forge a new global tax deal for the digital age is bound to forestall a much-needed discussion on the broader distributive implications of the current global tax deal. As this new deal takes shape, it looks set to recalibrate the international tax regime to ensure that most of the benefits of cross-border cooperation continue to accrue to the relatively affluent member states of the OECD.4 To be sure, room must be made

3 The 2019 OECD work program, supra note 1, at 23, note 4: “In the context of the programme of work, the term ‘market jurisdiction’ refers to the jurisdiction where the customers of the business are located or, in the case of businesses that supply services to other businesses, the jurisdiction where those services are used. In the context of many digitalised business models, this definition would cover the jurisdiction where the user is located either because the user acquires goods or services directly from the on-line provider or because the on-line provider provides services to another business (such as advertising) targeting such users.” In a recent policy paper, the International Monetary Fund (IMF) defines a “market country” as being the same as a “destination country”—that is, a country where the purchaser is located. See “Acronyms and Glossary” in International Monetary Fund, Corporate Taxation in the Global Economy, Policy Paper no. 19/007 (Washington, DC: IMF, 2019) (www.imf.org/en/Publications/Policy-Papers/Issues/2019/03/08/Corporate-Taxation-in-the-Global-Economy-46650).

4 See, for example, Stephen E. Shay, “Comment on Selected Aspects of Proposals in Public Consultation Document on Addressing the Challenges of the Digitalization of the Economy,” submission to the Organisation for Economic Co-operation and Development, Centre for Tax Policy and Administration, Tax Policy and Statistics Division, March 6, 2019, at 3 (https://doi.org/10.2139/ssrn.3349186): “The proposed time line for this project is too
for a few other key states, but the plan, despite its apparently universal scope, still stands to leave many others, including most lower-income states, largely out of the core discussion. If so, the process would continue a long tradition of exclusion in international tax policy making, even while it demonstrates the clear need for a holistic discussion of what states owe each other in designing the distribution of taxing rights.

The aim of this paper is therefore to critically examine the emerging new global tax deal for the digital age, and in particular the decision to draw up new taxing rights that will mainly benefit a relatively small number of states while leaving the policy priorities of other states to be addressed another day, or not at all. The first part of the paper provides a brief survey of some of the main factors that prompted the OECD to turn its attention to this topic. The second part considers the origins and development of nexus and profit allocation in the international tax regime, showing why these concepts are amenable to broad expansion and examining the range of reforms currently under consideration. The third part examines the likely winners and losers of the proposal to define a new taxing right within the currently demarcated framework, and shows that the framing on digitalization misses a necessary connection to other pressing international policy programs that are simultaneously under development, most notably a global commitment to building institutions that support sustainable economic development.

The paper concludes with a prediction that the 2019 OECD work program on digitalization, if it continues on its current trajectory, is likely to produce a new global tax deal that looks much like the old global tax deal, with a relatively modest redistribution of taxing rights among a few key states. Since such an outcome would not resolve pressing issues involving the rest of the world, it would represent a missed opportunity for the international community. A more holistic approach would undoubtedly take more time and prompt states to act unilaterally in the interim, but uncoordinated unilateral action will be the long-term result in any case if a consensus based on a more narrow scope provides no satisfactory answers to the pressing concerns of many states.²

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² See, for example, Tim Edgar and David Holland, “Source Taxation and the OECD Project on Attribution of Profits to Permanent Establishments” (2005) 37:6 Tax Notes International 525-39, at 532, stating that “an allocation method should be seen to be fair, in the sense that it is accepted by a wide range of jurisdictions as implementing an acceptable division of revenue . . . [and] the detailed rules of any allocation method should be robust against taxpayer manipulation. Otherwise, the realization of the accepted allocation of the income tax base is undermined”; Tim Edgar, “Corporate Income Tax Coordination as a Response to International Tax Competition and International Tax Arbitrage” (2003) 51:3 Canadian Tax Journal 1079-1158, advocating for the international adoption of rules aimed at achieving consistency in tax treatment to counter the perfect substitutability of lower-taxed with higher-taxed transactions, which is a condition created by mobile investment capital.
VALUE AND THE DIGITAL ECONOMY

The 2019 OECD work program was announced in May 2019, following a proliferation of uncoordinated moves by various states to tax digital giants, notably Google, Amazon, Facebook, and Apple.6 In early 2018, the European Commission (EC) had proposed the introduction of the concept of “digital permanent establishment,” together with a temporary digital services tax.7 Spain, Italy, the Czech Republic, Austria, and New Zealand soon announced their intention to follow suit.8 France acted in mid-2019,9 adopting a digital services tax that generated a great deal of public debate—including opposition from the United States in the form of a presidential tweet threatening retaliatory action.10 Following the fall Group of Seven (G7) meeting, however, President Macron announced that an agreement had been

6 The 2019 OECD going-digital policy note, supra note 1, at 1: “While the introduction of unilateral measures in a number of countries has underscored the urgency of the issue and the need to re-assess some of the key international tax principles, these divergent positions have made a consensus-based solution difficult to achieve.” The concern is the re-emergence of tax unilateralism, and the rise of multiple forms of taxation that would discourage cross-border investment. See Reuven S. Avi-Yonah, “Three Steps Forward, One Step Back? Reflections on ‘Google Taxes’ and the Destination-Based Corporate Tax” [2016] no. 2 Nordic Tax Journal 69-76 (https://doi.org/10.1515/ntaxj-2016-0007), discussing the United Kingdom’s diverted profits tax (DPT), Australia’s multinational anti-avoidance law (MAAL), and India’s equalization levy; Ricardo Garcia Antón, “The 21st Century Multilateralism in International Taxation: The Emperor’s New Clothes?” (2016) 8:2 World Tax Journal 147-92, at 167, questioning the alleged shift to multilateralism in international tax and stressing the persistence of “unilateralism as always”; Arthur J. Cockfield, “Shaping International Tax Law and Policy in Challenging Times” (2018) 54:2 Stanford Journal International Law 223-40, claiming that recent global trends such as nationalism, populism, and anti-globalization reinforce unilateralism in international tax.


10 Donald J. Trump, @RealDonaldTrump, Twitter.com, July 26, 2019: “France just put a digital tax on our great American technology companies. If anybody taxes them, it should be their home
forged that would permit the United States to forestall action pending the development of consensus at the OECD. The OECD certainly has its work cut out for it.

In its program of work to deliver such a consensus, the OECD laid out three possible approaches involving the concepts of user participation, marketing intangibles, and substantive economic presence. Each proposal includes some combination of an expansion of nexus in some form, a redefined concept of source, and a reallocation of multinational profits. The user participation proposal seeks to reallocate a portion of global profits by reference to the value created by “highly digitalised businesses” that engage users in order to sell to them as well as solicit data from them. The marketing intangibles proposal seeks to reallocate a relatively smaller portion of global profits of businesses in general (whether highly digitalized or not) by reference to the value created by intangibles that reach users in a market, such as branding, marketing efforts, and customer lists. The significant economic presence proposal seeks to expand nexus and reallocate total income on a formulary basis, with user participation added to the traditional apportionment factors. The OECD’s secretariat subsequently combined elements of the user participation and marketing intangible approaches in a proposed “unified approach,” which it released for public consultation in October 2019.

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11 Emmanuel Macron, @EmmanuelMacron, Twitter.com, August 26, 2019: “Some digital players pay very little tax. This is an injustice that destroys jobs. @realDonaldTrump and I have just agreed to work together on an agreement at the @OECD level to modernize international tax rules.” See also Michel Rose, “Macron Defuses French Digital Tax Row, Trump Coy on Wine Threat,” Reuters.com, August 26, 2019 (https://ca.reuters.com/article/businessNews/idCAKCN1VG0N5-OCABS).

12 2019 OECD work program, supra note 1, at 11.

13 Ibid., at 12; see also Organisation for Economic Co-operation and Development, OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (Paris: OECD, July 2017) (herein referred to as “the OECD transfer-pricing guidelines”), at 27: “An intangible (within the meaning of paragraph 6.6) that relates to marketing activities, aids in the commercial exploitation of a product or service and/or has an important promotional value for the product concerned. Depending on the context, marketing intangibles may include, for example, trademarks, trade names, customer lists, customer relationships, and proprietary market and customer data that is used or aids in marketing and selling goods or services to customers.” In practice, marketing intangibles are very difficult to define and difficult to distinguish from other intangibles and attributes. See, for example, Shay, supra note 4, at 4: the difference between marketing and trade intangibles is “a distinction that is not well defined and not capable of meaningful definition.”


15 See the 2019 OECD secretariat unified approach, supra note 1.
Each approach contends in some way with the conventional wisdom of international tax. It is therefore useful to consider the OECD work program in light of the consensus it seeks to disrupt. That is the goal of the discussion that follows.

Establishing Presence

One of the broad challenges requiring OECD resolution is that foreign-based multinational firms access local users as customers (which is not a new phenomenon) and turn the customer experience into data that generate independent value (which is), and that they do so while avoiding threshold rules that would make any of these activities taxable in source states.\(^{16}\) Even though the underlying model of remote sales of goods and services is familiar to tax policy makers, some of the characteristics of digitalized firms, and the kinds of value they derive from their user bases, deviate notably from tradition.

For example, although advertising revenues are nothing new in the international economy, digital media businesses that combine online services with social networks take the potential value generated from advertising to unusual extremes.\(^{17}\) Value starts building when a firm provides a familiar service (for example a video game platform) but then grows exponentially when the core service is combined with communication services (such as instant messaging). The firm generates revenues through a combination of familiar modes: fees, subscriptions services, and advertising, yet the long-term value of the firm depends on building and expanding its network so as to extract more, and more useful, data. When combined across users and over time and analyzed via increasingly sophisticated algorithms, the relationship between users and firms becomes increasingly complex and increasingly valuable.\(^{18}\) This is why companies—and not just governments—are busy “collecting it all.”\(^{19}\)


\(^{18}\) This is the model of most social networks, including Instagram, now owned by Facebook, which announced that it had reached 2 million active advertisers in 2017; the company claims to have 500 million active users, thus one advertiser for every 25 users. See “2M Monthly Advertisers on Instagram,” *Business.Instagram.com*, September 25, 2017 (https://business.instagram.com/blog/welcoming-two-million-advertisers).

\(^{19}\) Glenn Greenwald, “The Crux of the NSA Story in One Phrase: ‘Collect It All,’” *Guardian*, July 15, 2013. Amazon proves illustrative in its privacy notice, which states that its collection policy is to “receive and store any information” that a user enters on its website or “give[s] us in
Comparison to Barter Transactions

From the perspective of applying the tax system to these phenomena, a conventional way to explain user-generated value is by reference to barter. That is, when an individual becomes a user of a platform or a purchaser of a good or service, this interaction provides a set of data points that are collected by the vendor and used to (1) advertise to particular users in hopes of generating additional sales from them; (2) attract new users and advertise to them; and (3) package multiple users’ information for sale to third parties, including business partners and unrelated advertisers.

The barter analogy is inapposite, however, when significant value derives from the interaction of multiple users over time and with future applications not yet determined or determinable. This is the case when value derives from network effects and content posting by influential users, who attract other users (the influenced) independent of the platform or company’s efforts. It is also the case when firms collect data that are not very valuable at the time of collection but become valuable with the advance of new technological developments.

Integration of Data and Analytics

How much value is generated by these interacting phenomena is difficult to judge, even if it is clear that modern businesses are built on them. In terms of barter, absent aggregation and analytical tools, the value of a single user’s information, network, or content is likely negligible at the time of the transfer. Yet aggregation and analytical tools are obviously also worth very little without the data to feed them, improve on them, and discover new uses for them. The problem is difficult, and data mining is by no means the only source of user-generated value, but it offers a conceptual analogue that tax policy makers can grasp and therefore feed into the existing set of rules.

In recent work, Johannes Becker and Joachim Englisch argue for some restraint in this quest, since in their view most data harvesting is passive on the part of the user, with the business, not the user, producing, storing, and analyzing what they characterize as otherwise useless raw data. Becker and Englisch contend that even if the user’s data or input is considered independent of whatever the company does any other way,” including the user’s location and mobile device: see Amazon, “Amazon Privacy Notice,” August 29, 2017 (www.amazon.com/gp/help/customer/display.html?nodeId=468496), under the heading “What Personal Information About Customers Does Amazon.com Gather?”

20 See 2018 OECD interim report, supra note 1, at paragraph 145: “[D]igitalisation has reshaped the role of users, allowing the possibility for them to become increasingly involved in the value creation process.”

21 This is in no way a revelation. See, for example, Erik Brynjolfsson and Adam Saunders, “What the GDP Gets Wrong and Why Managers Should Care” (2009) 51:1 MIT Sloan Management Review (online), noting that “the irony of the information age is that less is known today about the sources of value in the economy than was known 25 years ago.”

with it, significant change is not warranted because the information is very hard to value in terms of uncompensated labour and is, in any case, often compensated with free or discounted services or with the emotional returns of popularity and influence.\textsuperscript{23}

This seems plausible, yet states continue to seek tax reform anyway. The reason likely has something to do with the sheer growth of digital retail platforms over the past 20 years, which suggests that the aggregate value of user data must be significant.\textsuperscript{24} In 2018, some 1.77 billion people around the world purchased over US$1.5 trillion in consumer goods via digital platforms.\textsuperscript{25} Amazon went from having 1.5 million active users in 1997 to having 310 million by 2016.\textsuperscript{26} Whether states with large user bases are actually suffering in terms of losing out on tax revenues to which they are entitled—a debatable proposition, in the view of Becker and Eng- lisch, among others—the public spectre of multinational conglomerates accessing so many users without apparently paying much tax anywhere has provided policy makers sufficient reason to call for international reform.

It is clear that collecting, aggregating, analyzing, and deploying user information is a key value driver, if not the raison d’être, of many digital businesses. Further, as the increasing value of data appears to permeate the economy, states may fear the consequences of failing to act in an urgent manner. For example, fashion—a decidedly non-digital commodity\textsuperscript{27}—has been identified as the largest and fastest growing business-to-consumer e-commerce market segment because mass personalization, such as custom tailoring by a company in accordance with its end users’ tastes and

\textsuperscript{23} Ibid., at 169, discussing the difficulties involved in assessing the value added by uncompensated labour; see also Allison Christians and Laurens van Apeldoorn, “Taxing Income Where Value Is Created” (2018) 22:1 Florida Tax Review 1-39, discussing value creation in the case of undercompensated labour in traditional supply chains.

\textsuperscript{24} See 2018 OECD interim report, supra note 1, at paragraph 8, describing the enormous and growing amount of data generated by users and devices, all of which is being collected by governments and businesses in order to provide “the insights necessary to transform and shape the way people behave and organizations operate.”


\textsuperscript{27} Barring wearable technology (which includes smart watches and Fitbits and the like), a small but growing market segment. See, for example, Rachel Arthur, “The Future of Fashion: 10 Wearable Tech Brands You Need To Know,” Forbes, June 30, 2016 (www.forbes.com/sites/rachelarthur/2016/06/30/the-future-of-fashion-10-wearable-tech-brands-you-need-to-know/). Cisco Systems estimates that there were 593 million connected wearable devices in use in 2018, up from 325 million in 2016. See Shanhong Liu, “Number of Connected Wearable Devices Worldwide from 2016 to 2022 (in Millions),” Statista.com, September 19, 2019.
preferences, and recommendation features are among the main benefits for consumers in this market.\textsuperscript{28} It is axiomatic that personalization requires customer data, while giving recommendations requires comparing customer behaviours. When customer data become a main profit driver even in the most conventional industries, it is not hard to understand why states might seek to assert taxing rights.

These potential user-generated sources of value, and countless others like them, raise questions that seem to perfectly exemplify the fundamental problem that has always plagued international taxation, namely, that international activities and transactions are by their very nature the product of synergistic combinations of labour, capital, and resources across borders. Disaggregating the product of these synergies in order to allocate taxing rights to one jurisdiction or another is a political challenge that has become an essential task for tax policy makers, starting from the threshold problem of nexus and carrying over into the allocation of profit for tax purposes.\textsuperscript{29}

\textbf{THE ESSENTIAL MALLEABILITY OF NEXUS}

Even as states started articulating rationales for taxing foreign digitalized businesses on the basis of user data, a 2014 report on the digital economy rejected the idea that data collection alone should create tax nexus, and called for restoration of nexus provisions through existing rule sets, specifically concerning the definition of “permanent establishment.”\textsuperscript{30} It is not clear what restoration means in this context. An examination of the concept of nexus shows why clarity will likely remain elusive.

\textbf{Normative Framing}

Nexus is an enduring structural feature of international tax law and policy, but it is an extremely accommodating concept—much like the concept of value creation itself.\textsuperscript{31} Revisiting nexus provides a useful reminder that some concepts viewed as


\textsuperscript{29} Hence the OECD’s recognition that its work to resolve the tax challenges arising from digitalization “may reach into fundamental aspects of the current international tax architecture.” See the 2019 OECD policy note, supra note 1, at 2.

\textsuperscript{30} The 2014 EC report, supra note 16. This view is echoed in the policy recommendations of the Business Industry Advisory Council to the OECD. See Business at OECD (BIAC), Business Principles for Addressing the Tax Challenges of the Digitalizing Economy (Paris: Business at OECD (BIAC), January 2019), at 2, stating that any reforms should “be based on long-standing and well-founded underlying principles of international taxation,” which are identified as “taxation of net income, nexus, permanent establishment, and transfer pricing based on the arm’s length standard.”

conceptually sound are not actually coherent, despite their core significance. This is mainly because these concepts are the product of political compromise.

A century ago, as the growing popularity of income taxation worldwide made competing claims over the same income likely to produce double or multiple taxation, the League of Nations struck a committee of four economists to study standards for demarcating tax jurisdiction claims, with a view to ensuring that excessive taxation would not impede international investment. The economists laid out a framework for dividing the tax base that endures today and forms the starting point for virtually every discussion about international taxation. Their report, published in 1923, sought to define the jurisdiction to tax as a function of what they termed “economic allegiance.”

Economic allegiance arose from the sense that the tax base, as a product of economic activity, must be understood not in terms of a taxpayer’s political or social connections to a country, but by their economic interaction with and within it. Conceptually, economic allegiance satisfies some version of benefit theory, connecting the person to the state as a threshold matter by holding the intuitive appeal when thinking about nexus that people should contribute where they receive benefits. But neither economic allegiance nor benefit theory solved the base distribution issues of their day, and they are hard pressed to solve the challenges arising from the digitalization of the economy now. Instead, owing to the practical impossibility of


32 See, for example, Edgar and Holland, supra note 5, at 532, discussing the implicit preference of the OECD for perceived consistency among various international tax allocation rules, despite the lack of coherent economic rationale and the “element of arbitrariness” that the authors viewed as inherent in any form of allocation.


34 See the 1923 economists’ report. This was a reasoned step away from the citizen/state relationship traditionally understood to confer jurisdiction in public international law terms, because the state’s ability to tax must inherently extend to non-citizens.

35 The 1923 economists report, at 19.
assigning income to particular geographic sources, dividing the global income tax base was and continues to be a question of political feasibility, not science.\textsuperscript{36}

In thinking about the problems of their day, the economists of the 1920s made the same observation as contemporary economists make today when thinking about digitalized businesses, namely that a dollar produced in the global economy is the product of multiple cooperative interactions among states designed to make international transactions possible. The production of value relied then, as it does now, on a range of international legal and physical structures to allow access to new markets, enforceability of contracts, currency exchange, exchange of labour and knowhow for compensation in multiple states, and so on. The greater economic interdependence that states achieve via the multitude of international agreements on trade, investment, and commercial activity, the harder it is to explain how nexus can be viewed as restricted in any theoretical sense.

**Theoretically Unlimited Scope**

Given conventional definitions, there is no clear principle that explains why it would be unreasonable for states that developed core infrastructure or that are strategically important to international trade and investment flows to claim much broader taxing rights than they do currently.\textsuperscript{37} The results would be politically un-acceptable but they would be defensible interpretations of the fluid concepts at play. For instance, the United States might make a case for appropriating most tax revenues on digitalized profits wherever generated by virtue of the fact that the digital economy as a whole is a product of the Internet, the initial development of which was underwritten by US government spending.\textsuperscript{38} Indeed, were it not for high-risk investments by US public sector agencies, tech giants would not even exist.\textsuperscript{39}

\textsuperscript{36} The 1923 economists report, at 49–50: “[W]e do not see any other form of compromise which is likely to reconcile the conflicting interests and to have any prospect of success upon three points: (1) to reconcile the widely opposed interests of debtor and creditor exchequers; (2) to admit those ideas which, though widely accepted in many countries, are, in our view, in relation to income tax, to a considerable extent economically undeveloped in so far as they ascribe undue importance to origin taxation; and, lastly, (3) to conform to what is, in the experience of fiscal administrations, practically possible in dealing, in such a complex world, with the income of individual persons.”

\textsuperscript{37} Public international law theorists posit that there are customary constraints on sovereignty that must limit nexus to some degree. For a review of the literature, see Stjepan Gadžo, “The Principle of ‘Nexus’ or ‘Genuine Link’ as a Keystone of International Income Tax Law: A Reappraisal” (2018) 46:3 Intertax 194-209; Stjepan Gadžo, Nexus Requirements for Taxation of Nonresidents’ Business Income: A Normative Evaluation in the Context of the Global Economy (Amsterdam: IBFD, 2018). Practical experience, however, weighs against this view, even if it is conceptually coherent.


\textsuperscript{39} Ibid., at 87: “[W]ithout the massive amount of public investment behind the computer and Internet revolutions, [Steve Jobs’] attributes might only have led to the invention of a new
By the same token, the Cayman Islands is a financially sophisticated jurisdiction that facilitates capital pooling by individuals and companies across the globe in shared projects—especially hedge funds. Using economic allegiance as the explanation for nexus, the Cayman Islands might plausibly claim that but for its provision of international financial services, much less investment across borders would occur, so anyone buying or selling anything that is ultimately funded through international capital markets might be seen to have nexus in the Cayman Islands.

Both of these assertions must be wrong, but neither economic allegiance nor the benefit theory explains why. In practice, the United States does not overtly attempt to claim nexus on the basis of its past investment in key infrastructure (but may bring that view of its taxing rights to many tax negotiation scenarios), while nexus claimed by the Cayman Islands undergoes near constant scrutiny for being artful rather than substantive. Indeed, the history of OECD work on harmful tax practices has been a challenging definitional exercise with the goal of denying taxing rights to countries like the Caymans, on the grounds that the real or substantive economic activity is elsewhere, without similarly invalidating other forms of tax competition in use by OECD member states. Relying on the idea of economic allegiance or benefit theory as the explanation of nexus for digital services revisits these notorious difficulties.

**Precedents, Challenges, and an Uncertain Future**

The conclusion to be drawn is that today’s search for new rationales for nexus is made possible precisely by yesterday’s acceptance of a broad standard susceptible to vastly different interpretations. The broad standards of the past were controlled by limiting the discussion topics and the range of possible actions to those considered politically viable by the OECD member states. Against the theoretically unlimitable scope of nexus, the attempt to demarcate taxing rights by reference to value creation thus seems simply to compound the number of ideas that will have to be explained.

This confirms that there is a deeply political nature to the decision to open an international discussion about what nexus and value creation might mean, but to do so in the limited language of the digital economy. Lacking a scientific or technically correct answer to most questions about nexus and profit division leaves policymakers to defend a weak rule set. Hence the current discussion about whether nexus needs to be redrawn is fundamentally about which states stand to gain, and which to lose, once the next political compromise is forged.

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40 In explaining its intention to develop “conceptually underpinned methods” to assign new taxing rights, the OECD posits only one criterion—namely, “the principle of avoiding double taxation.” Limiting burdens on tax administrations and taxpayers and assessing other administrability issues are included as additional “issues and options” to be explored. See the 2019 OECD work program, supra note 1, the box “1.1 new profit allocation rules.”
DEFINING AND ASSESSING A NEW TAXING RIGHT

Given the above, redrawing nexus to accommodate the digital economy is not likely to satisfy any coherent normative standard. As currently framed, the discussions underway at the OECD will in effect demarcate a position from which to meet the political aims that a specific set of states view as urgent without exposing the overall residence and source bargain to critical debate. This might allow for a faster redesign of the jurisdictional reach of taxation for the current digital era, but it potentially does so at the expense of systemic coherence going forward, thus resetting the 1920s compromise without actually improving on it.

Four Approaches, Four Constituencies

Each of the OECD documents and reports is clear in regard to the targets of reform: states in which digital services businesses connect with many users without having any physical presence, that is, market jurisdictions. In particular, pillar 1, laid out in the 2019 OECD work program, aims to outline a new taxing right for these states by revising profit allocation and nexus rules.41 As introduced above, this is expected to be undertaken by reference to one of three approaches, based on concepts of user participation, marketing intangibles, and significant economic presence.

The three concepts converge in the sense that each would allot a greater portion of multinational profits to market jurisdictions.42 What sets them apart is the amount of tax base redistribution each contemplates. Defining these as the only possible measures, the OECD sheds light on an emerging dynamic of preferences and interest groups at play in global tax governance, highlighting divisions in country groupings and exposing how old and new players in contemporary world politics work within the structures of international tax—as well as how the OECD reacts, manages, and adapts to their strategic actions.43 The three main groups of market countries in this

41 Ibid., at paragraph 39: “The work programme will explore the development of a concept of remote taxable presence (i.e. a taxable presence without traditional physical presence) and a new set of standards for identifying when such a remote taxable presence exists. The work programme will also consider a new concept of taxable income sourced in (i.e. derived from) a jurisdiction. This taxing right would generally not be constrained by physical presence requirements.”

42 Ibid., at paragraph 40: “Developing a new non-physical presence nexus rule to allow market jurisdictions to tax the measure of profits allocated to them under the new profit allocation rules.”

43 See Mindy Herzfeld, “The Case Against BEPS: Lessons for Tax Coordination” (2017) 21:1 Florida Tax Review 1-59, at 24: “[T]hese global power shifts are evident in the role the OECD adopted for itself in the BEPS project. While historically the OECD was organized to address the concerns of its member countries, primarily drawn from the wealthier countries in Western Europe and North America, it expanded its agenda as part of the BEPS project to make its work more relevant to emerging market economies. At the same time, its primary allegiance remains to its member countries, who fund the organization.”
round of tax coordination seem to be, roughly, the European Union, the United States, and a group of key emerging economies (especially Brazil, India, and China).44

**EU Preference: User Participation**

The first proposal, focused on the concept of user participation, expresses the preference of certain European states to tax large digital companies. The direction of the user participation proposal is to attribute value to user data, whether collected for internal use (for example, to sell goods and services to existing users, to attract new users, or to sell advertising space on digital platforms) or to package and sell on to third parties.45 Since most of the major multinational companies that collect, use, and sell data in this way are US-based, notably Google, Amazon, Facebook, and Apple, this is viewed as an aggression from the US perspective.46

**US Preference: Marketing Intangibles**

The United States proposed a second option: taxing rights based on marketing intangibles.47 This proposal would be expected to shift profits from Europe back to marketing intangibles located in the United States.48 Proposals by major multinational firms such as Johnson & Johnson and Uber are evidence of a prevailing view that it is difficult to define marketing intangibles and that a workable plan would require simplifying proxies and calculations.49

Both the user participation and the marketing intangibles proposals focus on changing the allocation of so-called residual profits. Residual profits are those that exceed the expected routine return to a given set of transactions or activities. Estimating expected routine profits is an imperfect art.50 A recent study describing the

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47 *Corporate Taxation in the Global Economy*, supra note 3, at paragraph 89.
50 *Corporate Taxation in the Global Economy*, supra note 3, at paragraph 95, stating that there is a high concentration of residual profits among a small number of companies headquartered in a
battle between the United States and Europe over such residual profits shows that high-tax countries tend to concentrate their efforts on reallocating profits from one another, because this is more feasible, cheaper, and faster than, for example, combating the allocation of profits to low-tax regimes or jurisdictions.51

**Group of Twenty-Four Preference: Significant Economic Presence**

The third proposal is more radical: instead of reallocating residual profits alone, it seeks to replace the arm’s-length standard with a “fractional apportionment method,” which would be used to allocate global profits among all states in which a digitalized business has a significant economic presence. This proposal would define “significant economic presence” by reference to various factors involving digital interaction with a jurisdiction.52 It has the greatest potential to redefine how countries share the corporate income tax base between residence and source states.53

This approach was featured in a recent Indian public consultation document on amending rules for profit attribution to permanent establishments, signalling that this proposal originated in India.54

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52 Avi-Yonah and Kir, supra note 48, at 1184.

53 Ibid., at 1190; see also Shay, supra note 4, at 1: “[T]he greatest potential to achieve a meaningful realignment is the ‘significant economic presence’ proposal in the first pillar, provided that it is not linked exclusively to digital activity (which in concept it is not or need not be),”

54 See Government of India, Ministry of Finance, Department of Revenue, Central Board of Direct Taxes, “Public Consultation on the Proposal for Amendment of Rules for Profit Attribution to Permanent Establishment-reg,” document no. F. no. 500/33/2017-FTD.I, April 18, 2019, and accompanying documents (herein referred to as “the India consultation document”) (www.irsionline.gov.in/Documents/OficialCommunique/118042019150655.pdf); see also Avi-Yonah and Kir, supra note 48, at 1185, stating that the Indian proposal “presumably inspired the third OECD option.”
The Indian public consultation document proposed that user participation be a fourth factor added to the traditional three-factor formula for profit allocation—namely, that based on sales, employees (usually counted in terms of payroll), and assets. Characterizing the authorized OECD approach based on functions, assets, and risk as detrimental to the interests of source countries, this report argued that the Indian formula gives proper weight to demand-side value drivers while addressing digital economy issues.

Pascal Saint-Amans, director of the OECD’s Center for Tax Policy and Administration, confirmed these observations in an OECD Tax Talk in October 2019. Setting out the possible combinations of nexus and allocation methods involved in the three approaches, Saint-Amans attributed the user participation proposal to the United Kingdom, the marketing intangibles proposal to the United States, and the significant economic presence proposal to the group of developing countries, including China, India, and Brazil, that make up the G24.

That a group of mostly non-OECD member states can now make their voices heard with some meaningful impact could be seen as a reason for celebration. Nevertheless, the 2015 BEPS final report stated that “fractional apportionment” is too extreme and unconventional, while the 2019 OECD public consultation document focused on the common ground between the user participation and the marketing intangibles proposals. This signals that the significant economic presence proposal has a much lower likelihood of ultimate adoption.

Even if the proposal were to succeed in building consensus, however, it would not necessarily promote pure source taxation. Within the OECD’s framing of the discussion, the allocation keys would still have to reflect the attributes of market

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55 The India consultation document, supra note 54, at 74-76.
56 Ibid., at 47-54.
59 The 2015 BEPS final report, supra note 1, at paragraph 288: “It is important to note that the domestic laws of most countries use profit attribution methods based on the separate accounts of the PE, rather than fractional apportionment. In addition, fractional apportionment methods would be a departure from current international standards. Furthermore, pursuing such an approach in the case of application of the new nexus would produce very different tax results depending on whether business was conducted through a ‘traditional’ permanent establishment, a separate subsidiary or the new nexus. Given those constraints, fractional apportionment methods were not pursued further.”
60 The 2019 OECD public consultation document, supra note 1, at 9: “To date, the discussion has focused primarily on two of these proposals, the user participation proposal and the marketing intangible proposal, where a number of commonalities emerged. A detailed discussion of the concept of significant economic presence is also taking place, but this concept was revisited more recently.”
jurisdictions,\textsuperscript{61} which may or may not align with the value contributions of each G24 member, or other developing countries.\textsuperscript{62}

\textbf{OECD Secretariat: Unified Approach}

In October 2019, the OECD secretariat released its own proposal for a “unified approach” under pillar 1, which it developed taking into consideration the “different positions of the members of the Inclusive Framework.”\textsuperscript{63} Notably, the unified approach is the OECD staff’s own proposal, and not a representation of member state views per the usual OECD process.\textsuperscript{64} During the broadcasted announcement of the proposal, Pascal Saint-Amans introduced its principal drafter as Richard Collier, a former partner at PricewaterhouseCoopers, and since early 2019 a senior tax adviser at the OECD.\textsuperscript{65}

The OECD secretariat’s proposal builds on a number of ideas introduced in the pillar 1 consultation document. The primary components are a specific scope of application, a new non-physical nexus rule, a hybrid profit allocation rule that includes traditional transfer-pricing and new sales- or user-based allocation components, and a three-tier mechanism aimed at increasing tax certainty. The various components are articulated as three amounts, each of which represents a designated portion of the combined net profit of a multinational group that makes up its total global tax base. All of the terms are still to be defined, including the determination of the members of the group and the construction of the multinational’s consolidated income for tax purposes, but the secretariat’s proposal neatly lays out a framework for further discussion with these three tax base amount categories.

The first of the categories, “Amount A,” presents the most significant structural reform, given that it relies on a newly established (non-physical) nexus and introduces a new (sales-based) allocation formula for attributing some group profit.

\begin{itemize}
\item\textsuperscript{61} 2019 OECD work program, supra note 1, at paragraph 23: “[T]hey all allocate more taxing rights to the jurisdiction of the customer and/or user—hereafter, the ‘market jurisdictions’—in situations where value is created by a business activity through (possibly remote) participation in that jurisdiction that is not recognised in the current framework for allocating profits.”
\item\textsuperscript{62} See India consultation document, supra note 54, at 48, stating that developing countries are “where the market and consumers are located.” This may be true for India, as well as China and Brazil, but it is not the case for all G24 countries. See, for example, Tommaso Faccio and Valpy Fitzgerald, “Sharing the Corporate Tax Base: Equitable Taxing of Multinationals and the Choice of Formulary Apportionment” (2018) 25:2 Transnational Corporations 67-89, at 73, stating that “unlike developed countries, the gains for tax bases in developing countries from the different models of apportionment do depend crucially on the weights given to the factors in the respective formulae.”
\item\textsuperscript{63} The 2019 OECD secretariat unified approach, supra note 1, at 2.
\item\textsuperscript{64} Ibid., at 2: “The proposals included in this consultation document have been prepared by the Secretariat, and do not represent the consensus views of the Inclusive Framework, the Committee on Fiscal Affairs (CFA) or their subsidiary bodies.”
\item\textsuperscript{65} Supra note 57, referring to Mr. Collier as “the brain behind the unified approach under Pillar 1.”
\end{itemize}
to jurisdictions in which such a new nexus may be found. The tax base to be reallocated seems likely to be relatively modest. Using simplifying conventions to split a multinational’s worldwide profits into “routine” and “non-routine” portions, the secretariat proposes that only a portion of the residual (non-routine) profit be reallocated among market jurisdictions. Residual profit derived from factors such as trade intangibles, capital and risk, and innovative algorithms and software are to be excluded from the reallocation exercise.\(^66\)

The second and third tax base categories are referred to as “Amounts B and C.” Each of these would be calculated using existing profit allocation rules based on physical presence, but applying simplifications to reduce disputes. These amounts are not necessarily related to digitalization, but they support the OECD’s parallel project on international binding arbitration—an initiative that has to date faced resistance from some less-developed countries.\(^67\) Amount B presents an agreed fixed-return method (possibly varying by industry or region) for determining “baseline” (routine) marketing and distribution functions. In broad strokes, this resembles Brazil’s prefixed/predetermined profit margin approach.\(^68\) In turn, Amount C would allow market jurisdictions to use the arm’s-length standard to go beyond the prescribed Amount B when warranted to create more tax base in the market jurisdiction in cases involving additional profits or local functions in addition to marketing and distribution.

The OECD secretariat’s plan is definitionally complex but limited in application, albeit going beyond strictly digitalized economy firms. According to the scope section of the proposal, the new rules would reach only “large digital centric/highly digitalized

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\(^66\) A recent study analyzed the likely distributional impacts of the secretariat’s unified approach using country-by-country reports and other data sources and concluded that low-tax jurisdictions stand to lose some tax base but little or none of this would shift to the developing countries of the G24 and G77. See Alex Cobham, Tommaso Faccio, and Valpy FitzGerald, “Global Inequalities in Taxing Rights: An Early Evaluation of the OECD Tax Reform Proposals: Preliminary Draft,” October 2019, at 23 (https://osf.io/preprints/socarxiv/j3p48), stating that “[a] watered-down OECD approach, in which perhaps only 20% of an identified ‘residual’ profit is apportioned by sales, would yield much smaller benefits—just a fraction of a percentage point of current corporate income tax revenues for lower-income countries compared to 2 per cent for OECD countries on average and almost 4 per cent for the US; or from 8 cents to 18 cents per capita for lower-income country groups on average, compared to $8 per capita for the US.”).


and other consumer-/user-facing businesses,” possibly over a minimum revenue threshold of €750 million. Likewise, the proposed standalone nexus rule would use revenue thresholds adapted to market size for activities such as online advertising as the indicator of “sustained and significant involvement in a jurisdiction.” Finally, targeted carveouts are proposed for extractive industries and commodities, while financial services and other sectors may also be excluded from scope.

**Distributional Implications**

Ultimately, the digitalization program is concerned with states of destination (where the customers or users are situated), and not states of production, resource extraction, labour inputs, and so on. Without identifying market jurisdictions by name, the proposals provide that the definition would cover the location of users either by virtue of their acquisition of goods or services directly from the remote seller or by virtue of the remote seller providing services to another business—namely, advertising that targets such users. This seems universal: all jurisdictions seem to be locations of markets and consumers. Yet the threshold requirement of significance—together with the measures that will be introduced to simplify matters and provide certainty to taxpayers—may ultimately exclude most developing countries from the picture.

This possibility does not sufficiently occupy the attention of policy makers, even though it is a source of instability in the international tax regime. The risk of overlooking disparate impacts of policy choices is that the current consensus will continue to produce distributive outcomes that many states view as unfair to them.

This reaction was foreshadowed in the broad divergence of views among states regarding the OECD’s work to address digitalization—including with regard to the need for any change at all, as reported through 2018. Yet in January 2019, the

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70 See, for example, Tarcisio Diniz Magalhaes, “What Is Really Wrong with Global Tax Governance and How To Properly Fix It” (2018) 10:4 World Tax Journal 499-536, at 502, calling for “a more radical perspective that takes struggles in the international tax arena seriously.”

71 The 2018 OECD interim report, supra note 1, at paragraphs 25-29.
members of the Inclusive Framework are said to have agreed that it is a “fact” that all countries are “free to set their own tax rates or not to have a corporate income tax system at all,” while at the same time noting that unilateral actions to attract or protect a tax base will have “adverse consequences for all countries, large and small, developed and developing.”\footnote{The 2019 OECD policy note, supra note 1, at 2.} The inverse proposition is that a single consensus would benefit all, but this is seemingly impossible given that reallocation will shift income from some jurisdictions to others in an effort to preserve a zero-sum game so as to avoid double or multiple taxation.\footnote{See the 2019 OECD work program, supra note 1, at 23, note 4, emphasizing throughout that the goal is reallocation from one jurisdiction to another.}

The questions are: Which states stand to benefit from the reallocation in the form of revenue generation, and from which states will tax base be deducted? The states that have already passed unilateral taxes seem likely to be captured in the first category, but another way to estimate is to consider relative consumption levels across countries.\footnote{A complete analysis should, of course, also take into account differences in multinational enterprises, economic sectors, geographic regions, and other factors. The OECD has pledged to carry out an economic analysis and impact assessment of its proposals that includes levels of distribution of tax revenues across jurisdictions, taking into account differences between countries.} As a starting point, available OECD and World Bank data from 2017 provide a fairly clear picture of which states are the largest consumer markets. They are the United States, Europe, and China by a wide margin, followed by Japan, India, and Brazil, with Canada and Australia another step removed. (See figure 1.)

This distribution of the consumer base reflects a reality that has always shaped the relationship between international taxation and national interests: that even though lower-income states are associated with source, while relatively more affluent ones are associated with residence, states can have both residence and source interests, depending on the economic context.\footnote{See, for example, Corporate Taxation in the Global Economy, supra note 3, at paragraph 34, noting that the IMF recognizes the “longstanding tussle for taxing rights between ‘source’ and ‘residence’ countries—a critical issue for low income countries, which are primarily ‘source’ countries”; see also Shay, supra note 4, at 2, noting that “longstanding issues in the international tax system . . . have restricted the claim of source countries to tax economic activity that derives value from the source country and accordingly results in over allocation of income to residence countries,” and observing that “[i]n recent decades, the ‘residence’ country often is a low-tax intermediary country.”} This observation offers important lessons about why the digitalization discourse avoids the use of broader expressions like “source taxation,” which could incorrectly signal a shift of attention toward the international tax priorities that are of urgent concern to lower-income countries.\footnote{Such expressions appear more often in relation to pillar 2, which deals with anti-base erosion measures rather than tax reallocation. As the OECD explains, its “GloBE proposal,” like the BEPS project, would restore source-based taxation. See, for example, 2019 OECD work}
Using 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 OECD members and other key consumer market states. A focus on the 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.

77 This worry is confirmed in a number of recent studies. See International Monetary Fund, Spillovers in International Corporate Taxation, IMF Policy Paper (Washington, DC: IMF, May 9, 2014), at 40: “Advanced economies generally gain tax base whichever factor is used, while substantial tax base moves out of conduit countries; emerging and developing economies clearly gain base only if heavy weight is placed on employment”; Corporate Taxation in the Global Economy, supra note 3, at paragraph 80, stating that a global profit allocation framework tied to
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.

**Connection to Global Economic Development Targets**

Reallocation of the tax base should be seen as a “strong [political] imperative to act,” as the OECD declares. But it is difficult to justify urgent action solely because some relatively affluent states might be facing revenue losses because of digitalization. Instead, it is imperative to come to terms with the distributional impacts of the flawed system that the tax policy architects of the early 20th century forged to satisfy the political preferences of their day. The digitalization of the economy is a new phenomenon, and it clearly poses challenges for taxation in all states. The imperative to better allocate tax revenues has always been a live issue.

In particular, it seems unlikely that source states will, as a monolithic group, stand to benefit from the attention of global policy makers to the tax challenges arising from digitalization. It is more likely that some production- and resource-based source countries will have their urgent concerns put aside for another day. This is unfortunate, 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.

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78 The 2018 OECD interim report, supra note 1, at paragraphs 27, 408, and 514; and the 2019 OECD work program, supra note 1, at paragraph 11.

Surprisingly, 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. There exist some alternative approaches to allocation, such as location savings or fixed-margin pricing, that might produce distributional results different from those destined to be produced according to concepts such as user participation and marketing intangibles. Proposals to develop or expand the use of these alternatives have underlying rationales that are relevant to the discussion of nexus and profit allocation, yet these approaches seem destined to be sidelined even as the OECD seeks appropriate principles in its search for consensus.

**CONCLUSION**

Google, Amazon, Facebook, Microsoft, and Apple are household names that reach into countries around the world engaging billions of active users, deploying billions of advertisements, representing $3 trillion in market capitalization, and generating half a trillion dollars in revenue per year. That these five digital giants also notoriously pay very little in tax on a global basis is perhaps the main reason why the international tax community is addressing the notions of user-generated and data-driven value creation by urgently designing a reset of conventional nexus, source and allocation rules.

To date, however, the digitalization discourse has had little to do with determining what a principled allocation of taxing rights among nations would look like. Instead, in a re-enactment of the original consensus that built today’s international tax regime, the development of a new global tax deal for the digital age has involved mostly affluent states organizing themselves around what they view as feasible, and what they are willing to do and how far they are willing to go to maintain their historical privileges. The claims of less-developed countries that more taxing rights should be allocated to places where resources are extracted and where production takes place seem destined to remain subordinate to apparently more urgent concerns.

The OECD has stated that the need to alter the distribution of current taxing rights among states requires the support of underlying principles that would explain why the expected distributive impacts should be broadly accepted. The avoidance of double taxation has been suggested as the paramount principle, with adherence to traditional concepts of nexus or arm’s-length pricing suggested as corollaries. What has not been identified is the need for a principle regarding the distributional impact of any and all approaches to international tax coordination.

Accordingly, regardless of which proposal is ultimately adopted, it is likely that multiple states will benefit minimally or not at all from the consensus developed in today’s digitalization project. Since it is not reasonable to expect states to continuously go along with a consensus that does not benefit them, this omission is significant.

What is needed instead is to reconsider the overall structure of the rules that allocate taxing rights among residence and source states. This is a long-term project
to build a sustainable international tax system that would take significantly more time and effort than the OECD has given itself for solving the tax challenges arising from digitalization. It is a project that requires analysis and collaboration across the disciplines of law, political theory, economics, and accounting. It will require recursive development, testing, and assessment of various models with an eye not only to economic impacts and incentives and administrative feasibility but also to the core question of fairness. A commitment to tackling these challenges is the key to building an authentically new tax deal for the digital era.