

Kluwer International Tax Blog

Comments and Recommendations for the OECD “Unified Approach” to Digital Taxation

William Byrnes (Texas A&M University Law) · Monday, November 18th, 2019

We applaud the OECD’s 15–year effort since its 2005 publication of *E-commerce: Transfer Pricing and Business Profits Taxation* to address the challenges arising from the digitalization of multinational enterprises’ business models and the evolution of cross-border e-commerce. We support the 6 November 2019 comments of Dr. Lorraine Eden, our colleague, and Dr. Oliver Treidler, that discuss the serious risks and new complexity arising from replacing the bedrock arm’s length principle (‘ALP’) for application of Article 7 and 9 of the OECD Model Tax Convention (‘MTC’). Our comments and recommendations of 14 tax professionals and academics from 11 countries raise additional issues and concerns and propose additional recommendations including a counter-intuitive recommendation. Our comments and recommendations are submitted in our personal capacity and do not represent an official statement or position of Texas A&M University or of our respective employers.

We are in complete agreement with Dr. Eden’s recommendation that the OECD Transfer Pricing Guidelines (‘TPG’) and BEPS reforms already present the best framework to robustly manage base erosion and profit shifting risks for both developed and developing economies from emerging digital business models and e-commerce. As pointed out by our esteemed economist colleague Dr. Lorraine Eden in several articles, incremental modifications to the application of the arm’s length standard will re-align to express value generated within the modern global economy. The 1923 Economists Report commissioned by the League of Nations, adopted in principle by its members for the inevitable negotiation of the allocation of income generated by emerging global business, posited that taxation should be based on a doctrine of economic allegiance.

Yet, in acknowledgement that the quickened timeline for this current OECD ‘Unified Approach’ consultation is driven by the enactment or consideration for enactment of a withholding-based digital service tax by a score of countries with the likelihood of continued adoption among both OECD members and emerging economies, we propose a counter-intuitive recommendation that will enhance the opportunity for implementation of their recommendation. Counter-intuitively, we recommend that the OECD expand its investigation of a unified approach to include a withholding based system rooted in established substantive and procedural norms with the relief of double taxation provided via the established norms for foreign tax credits.

A withholding based system will not be trapped in the tar pit of formation and implementation in the development of a new international tax regime, thereafter mired in the lack of institutional knowledge and capacity of resources for audit and MAP. A withholding based system offers a

contrasted simplicity in relation to its implementation, including: (a) better procedural certainty for taxpayer and tax authority based upon current withholding regimes for services, (b) better revenue estimation for tax authorities, (c) less complex and expensive audits by tax authorities of taxpayers, (d) better tax risk management for taxpayers, (e) an established procedural system for relief of double taxation, and finally, (f) less cause for requiring MAP. Among proposals most likely to congeal into a uniform approach by March 2020, a withholding based system already has numerous adherents representing various economic strata. Thus, rather than running away from a withholding based system into a ‘brave new world’, the OECD should embrace it and shape its current contours of definitional income and source issues and range of rates. Thereafter, the respective OECD and UN committees may leverage economic theory and regulatory impact analyses, as was done in 1923, to modulate the withholding based system via the inclusive process of the OECD and UN MTCs while working within the context of the ALP bedrock of the OECD and UN TPGs to address Article 7 and Article 9 allocation issues resulting from intangible-based residual.

When we are speaking of the origin of wealth, we refer naturally to the place where the wealth is produced, that is, to the community the economic life of which makes possible the yield or the acquisition of the wealth. This yield or acquisition is due, however, not only to the particular thing but to the human relations which may help in creating the yield.

The current Unified Approach proposal, especially the ‘Amount A’ proposal, proposes an ‘out-of-the-box’ innovative regime that attempts to align to the doctrine of economic allegiance via the ‘market intangibles’ approach for recognition of value within the digital economy value chain. Yet, even if the Amount A is in alignment with the doctrine of economic allegiance, it is highly questionable whether the Amount A presents a better alternative than the current OECD TPG approaches and the arm’s length standard to address the concerns of the OECD, Global Forum, and UN International Tax Committee. The current Unified Approach proposal, in general, requires too many moving pieces that all must be agreed in a very short time frame to avoid haphazard implementation and the avoidance of multiple instances of double taxation of income. The new moving pieces include: (a) scope of application, (b) new unitary allocation formulae for MNEs within scope, (c) selection and definition of new nexus criteria, (d) new formulary apportionment for countries with a nexus claim, and (e) new multiparty MAP procedures. Moreover, the Unified Approach proposal is the least responsive to the OECD, Global Forum, and UN goal of simplicity within the context of available capacity. Moreover, the Unified Approach proposal for the Amount A may be nonresponsive to the concerns of distributive fairness driving the agenda.

Our recommendation aligns with the recognition that the expediency for the current Unified Approach proposal has been driven by the enactment or consideration for the enactment of a withholding-based digital service tax by a score of countries with the likelihood of continued adoption among both OECD members and emerging economies. Broadly, the digital service withholding tax measures limit applicability to enterprises that exceed a global revenue threshold on a group reporting basis and that exceed a local country revenue threshold. Enterprises that exceed both thresholds and that generate income from digital services sourced within a country are then subject to a withholding tax. Digital services income, in general, includes advertising on a digital interface, digital marketplaces, and selling data. The withholding tax amount ranges in general from two percent to seven percent. These facets of the current digital service taxes either enacted or proposed to represent a starting point of commonality for the OECD, in association with its Global Forum, and the UN International Tax Committee, to find an agreement for uniformity that may then be reflected within the respective MTCs.

A withholding based system offers the OECD the opportunity as a thought leader and influence agent to establish the parameters of an implementable regime built on legacy systems and procedural simplicity. A withholding based system offers: (a) better procedural certainty for taxpayer and tax authority based upon current withholding regimes for services, (b) better revenue estimation for tax authorities, (c) less complex and expensive audits by tax authorities of taxpayers, (d) better tax risk management for taxpayers, (e) an established procedural system for relief of double taxation, and finally, (f) less cause for requiring MAP. Moreover, among proposals most likely to congeal into a uniform approach by March 2020, a withholding based system already has numerous adherents representing various economic strata. Thus, the OECD should investigate commonality for definitional income issues, source of digital income issues, and the range

We attach additional comments and recommendations to contribute to the ongoing inclusive framework discussions and welcome the opportunity for a representative of our cohort to provide input at the 21 – 22 November 2019 public consultation. (see [SSRN full 10-page letter here](#))

On behalf of the [International Tax Risk Management Curriculum](#) Inaugural Cohort of Texas A&M University School of Law

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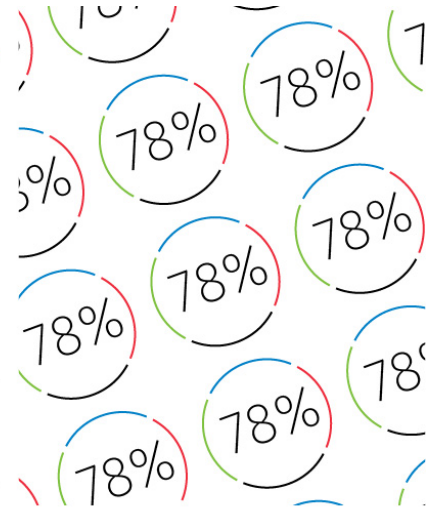
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