

Kluwer International Tax Blog

The Contents of Intertax, Volume 51, Issue 04, 2023

Ana Paula Dourado (General Editor of Intertax) · Monday, March 20th, 2023

We are happy to inform you that the latest issue of the journal is now available and includes the following contributions:

Stefan Greil, Michael Overesch, Anna Rohlfing-Bastian, Ulrich Schreiber & Caren Sureth-Sloane, *Towards an Amended Arm's Length Principle: Tackling Complexity and Implementing Destination Rules in Transfer Pricing*

The arm's length principle (ALP) is the cornerstone of multinational enterprises' (MNEs) profit taxation. However, despite extensive improvements by the OECD's Base Erosion and Profit Shifting (BEPS) Project, two aspects of the ALP have been widely criticized. First, market jurisdictions where MNEs serve their customers have little access to the MNEs' profits because there is often no place of supply for tax purposes or, if there is, the profits reported there are very low. This reduces the perceived fairness of profit allocations and the acceptance of rules by taxpayers and jurisdictions. Second, the rules governing the ALP have continuously become more complex and difficult to implement. Whereas the first point of criticism will presumably be addressed by Pillar One, the second has not yet been dealt with and is even more exacerbated by the BEPS Project. The authors suggest amending the ALP by attempting to effectively focus on its complexity and implementing destination rules. The former can be achieved with a reduction of functional analyses and information requirements as well as a standardization of margins reduces complexity while the latter target the allocation of MNEs' profits to market jurisdictions which they have in common with Pillar One. However, in contrast to Pillar One that rests on a multilateral agreement, the amended ALP is embedded in a bilateral context (usually a double tax agreement (DTA) and underlying transfer pricing guidelines). Keeping the bilateral character significantly reduces conflicts of interest between jurisdictions, simplifies tax enforcement, and offers important benefits for dispute resolution. This is assumed to increase the perceived fairness of profit allocations and acceptance of the ALP. A stylized example is used to demonstrate how the amended ALP can be applied.

Charles Garavan, *The Membership Theory of Taxation*

This article examines the theoretical basis of how one determines whether a person is sufficiently connected to a state in order for an obligation to pay tax to that state to arise. It focuses primarily

on the taxation of individuals and the theoretical underpinning of the connecting factors used to impose tax on individuals. The article outlines the various types of theory of taxation and their historical origins and development, including the benefit theory, the theory of economic allegiance and the ability to pay theory, and examines each as a candidate theory for defining and analysing connecting factors in taxation. The article argues that none of the principal taxation theories gives a good account of, or provides a sound theoretical basis for, determining how a person's connection to a state should be determined for tax purposes and proposes an alternative theory, the membership theory of taxation, which is then outlined and discussed.

Daniel Deak, Hungarian Tax on Digital Advertising Services in the Spotlight of Challenges

The paper first raised questions about the extraterritoriality issue on digital advertising services' taxation. Moreover, it addresses the application of a sales tax with progressive rates for these services. The paper emphasizes that linking sales taxes and tax progression is doubtful. In cross-border cases, justification problems may restrict fundamental EU freedoms and effectuate the issue of discrimination against those multinationals that provide services like publishing ads over the internet in Hungarian consumer markets.

Notably, the EU judicial authorities have acted in a formalistic manner. Specifically, they have matched the existing EU rules and principles with the advertising tax case without further consideration. Consequently, the Member States' legislative objective of redistribution, which refers to the ability to pay, was not reviewed on its merits.

While the government is seeking to hone the Hungarian advertising tax from 2023, the question is how long it will remain in force due to the international two-pillar agreement finalized by the OECD. The Hungarian tax has passed many tests, but the respective legal construction has remained unsecured and has not been intact from further challenges.

Natalia Quiñones, Beyond the 2-Pillar Solution: A Case for a Global Income Tax and the Creation of the International Tax Organization

Globalization, technological advancement, and the subsequent mobility of functions, risks, and assets in business activities present tax challenges that cannot be resolved with the existing rules. The Organization for Economic Co-operation and Development (OECD) attempted to reform the international tax system through what is referred to as the two-pillar solution consisting primarily of transferring a small portion of excess profits made by the largest multinationals to market countries (Pillar 1) and establishing a minimum 15% tax to be paid mainly in the residence jurisdiction of the ultimate parent of multinational groups (Pillar 2). Some of the agreements reached in this context may serve as grounds for a more global solution that actually resolves the issues brought by globalization and technology in a simple, inclusive, and sustainable manner. This policy brief proposes replacing current nexus rules for global taxpayers with the establishment of a global income tax by using the agreements on the calculation of the effective tax rate (ETR) for Pillar 2 and building a pilot with the multinationals selected as covered by Pillar 1. Further, the article argues for creating an international tax organization (ITO) to administer this tax, departing from the approval of the Resolution for the Promotion of Inclusive and Effective International Tax Cooperation at the United Nations in November 2022. Finally, the contribution proposes a bold

spending proposal aimed at effectively addressing global challenges like climate change, including a transitional regime to support countries giving up domestic revenues due to the implementation of the proposed solution.

Alexander Tale, New Targeted Interest Deduction Limitation Rules Post Lexel

Both the European Union (EU) Directive implementing the OECD's Pillar Two and the proposal for a debt-equity bias reduction allowance (DEBRA) feature rules that target and limit interest deduction as the need for these still exists. However, in case C-484/19 Lexel from 2021, the Court of Justice of the European Union (CJEU) struck down the Swedish targeted interest deduction legislation of 2013 applying to loans between associated companies. The Court considered the legislation to constitute an unjustifiable restriction of the freedom of establishment. It essentially stated that only wholly artificial arrangements could be the object of the targeted interest deduction rules while, at the same time, concluding that transactions carried out at arm's length cannot be considered artificial or fictitious arrangements. After Lexel, the question is whether targeted interest deduction rules that are drafted with the objective of combating tax base erosion have any future, or must Member States only rely on the application of anti-abuse rules or targeted interest deduction rules mandated by secondary EU law?

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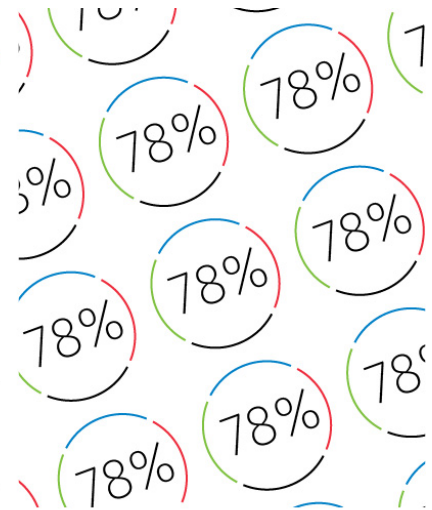
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