Kluwer International Tax Blog

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Ana Paula Dourado (General Editor of Intertax) · Tuesday, July 18th, 2023 · Intertax

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

Reuven Avi-Yonah, *Do Intangibles Fit BEFIT?*

This article argues that the BEFIT formula should not include intangibles because they are subject to manipulation and their value is reflected by other factors in the existing formula.

Cees Peters, *The Legitimacy of the OECD's Work on Pillar Two: An Analysis of the Overconfidence in a 'Devilish Logic'*

The objective of this contribution is to analyse the legitimacy of the OECD's work on Pillar Two. The starting point is that the effectiveness of the new global minimum tax is clearly based on its so-called 'devilish logic'. As such the project relies heavily on expert knowledge that is supposed to guarantee output legitimacy. At the same time, the consensus reached in the Inclusive Framework (IF) is supposed to bless the global minimum tax with a form of input legitimacy. Nevertheless, the contribution comes to the conclusion that the legitimacy of the OECD's work on Pillar Two is falling short. The central point is that the governance process of the OECD should meet burdensome standards of 'good' governance including accountability (i.e., throughput legitimacy). Unfortunately, the political accountability and the technical accountability of the work on Pillar Two were clearly insufficient. The OECD, and the Centre for Tax Policy and Administration (CTPA) in particular, was not appropriately operating 'in the shadow of politics' and the ingenious solutions of the global minimum tax were not sufficiently scrutinized by independent technical experts. As a result of these shortcomings, the legitimacy of the work on Pillar Two eventually relied too strongly on expert knowledge (the 'devilish logic') and therefore on output legitimacy only. This conclusion illustrates once more the urgent need to rethink the legitimacy of international tax governance in general and the role of the OECD in particular.

Vikram Chand & Camille Vilaseca, *Pillar I: The Marketing and Distribution Safe Harbour (MDSH) as Applicable to Licensed Manufacturers and Centralized Business Models: Does It Fulfil Its Policy Objective?*

The new Pillar I Amount A system aims to reallocate a portion of in-scope MNEs' residual profits to market countries. This said, there could be many instances when an MNE already reports residual profits in the market country under the current system, for example, when it operates with a substantial physical presence (which is entrepreneurial in nature) in the market country. In order to avoid the double taxation/double counting of what is known as 'residual profits', a Marketing and Distribution Safe Harbour (MDSH) mechanism was first developed in the 2020 Blueprint and

redesigned in the 2022 Progress Report. The purpose of this article is to address the question as to whether the MDSH as designed in the Progress Report meets its objective, particularly after briefly describing it as drafted in both reports. The authors analyse whether it does so by testing it against two commonly found MNE business models, i.e., a licensed manufacturer (LM) in the market and a centralized business model with limited risk distributors (LRD) in the market. A technical analysis is undertaken which is then illustrated with numerical case studies. The analysis leads to the conclusion that the MDSH as designed in the Progress Report does not necessarily meet its policy objective of preventing double counting under both the LM and the centralized business models. Thus, one possible policy option is to redraft it and return to the test as originally conceived in the Blueprint. A second possibility is to further reflect on some of the MDSH components, in particular, the manner in which jurisdictional routine and residual profits are calculated with the overall aim of achieving simplicity as well as accuracy. With respect to determining jurisdictional routine profits, our main recommendation is to deem a certain percentage of jurisdictional elimination profits (EPs) to represent routine profits (e.g., 25%). Such a mechanism would be simpler than the existing mechanism to determine jurisdictional routine profits, which seems to be rather complicated. With respect to jurisdictional residual profits, our recommendation is to support the Y% with a facts and circumstances analysis to achieve accurate results (at least, in certain cases). For instance, the Y% will be deemed to be 100% in a country when the MNE group operates with a fully or partly decentralized business model such as a LM (or similar business models such as franchise models). It will be regarded as being 0% in a country when it operates with limited risk sales structures or/and structures that have access to the simplification offered by the Amount B project. In all other cases, the Y% could be considered to be, for example, 25% in a country (which would be a compromise). Moreover, our recommendation with respect to withholding taxes (WHT) (if they are taken into account) is to restrict its scope to selected payments (e.g., royalties or service fees) and to provide a downward adjustment in the residence jurisdiction of the recipient (as opposed to the payors). The effect would be that the EP of the recipient would be reduced, and these profits would then represent the base to provide relief from double taxation. More broadly, if the Amount A project does not achieve fruition, the authors believe that some lessons that can be learned from the Amount A reform, in general, and the MDSH for future alternate reforms. Thus, a few suggestions will be made to policymakers who are considering alternatives to the Amount A project.

Ahmed A. Altawyan, ***Challenges in Applying Saudi Arabian Tax Treaties: Digitalization, Withholding Tax, and Permanent Establishment of Non-residents***

As part of Vision 2030, the Kingdom of Saudi Arabia (KSA) has begun implementing broad economic and legal reforms to improve its tax environment and create an amicable setting for international investors. However, there are challenges to this endeavour, which are not limited to Saudi rules. Digitalization is one such challenge in income taxation at the global level. This study investigates the challenges in taxation arising from digitalization that can potentially affect base erosion and profit shifting (BEPS) mechanisms both internationally and in Saudi Arabia. One major problem in the Saudi tax judiciary is the interpretation of international tax treaties to determine the existence of a permanent establishment (PE) for the purpose of Saudi income tax for a non-resident providing remote services within Saudi territory. By examining contradictory decisions related to two typical digital services, namely online travel companies (OTCs) and international telecommunication, this study highlights the complexity involved in digitalization, withholding tax, and PE. By analysing Saudi practices against the context of international rules, this research also highlights the need to clearly define the meaning of a ‘permanent digital

establishment'. Finally, it underscores the necessity of establishing a permanent higher chamber in the tax judiciary, which will make decisions on stable judicial tax principles. This will improve the Saudi legal tax environment and ensure its consistency with international practices.

Marta Papis-Almansa, ***The End Does Not Justify the Means: On How the Secondary EU Law Infringes the Primary EU Law in the Light of the Recent Judgments of the CJEU***

The constitutional character of the Union legal order based on the rule of law requires that secondary sources of Union law are not infringing the primary sources, including the Charter of the Fundamental Rights of the European Union (CFR). The latter's importance as a valid instrument to be invoked against measures that are excessive in their interference with the fundamental rights has recently been reinforced by the Court of Justice of the European Union (CJEU) in the judgments in cases such as C-694/20, Orde van Vlaamse Balies and Others, and joined cases C-37/20 and C-601/20, Luxembourg Business Registers and Sovim. The CJEU invalidated provisions of the Directive on Administrative Cooperation (DAC6) and 5AMLD which reminded that this is the case even when rules are motivated by important collective interests. These include the combat against tax evasion and tax fraud and enhancing broadly understood transparency and are agreed upon and are 'validated' by a Union's legislature. The lessons to be learned are not to be underestimated. Understanding where the limits lie is decisive for valid law making and law enforcement as well as for effectively invoking the rights of individuals and businesses.

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