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The OECD's inclusive framework on the challenges arising from the digitalisation of the economy, a revolution unfolding?

Author: Rodrigue Jadoul
Supervisor: Jean Hindriks
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Université catholique de Louvain - Economics School of Louvain - Place Montesquieu 3, 1348 Louvain-La-Neuve
Université de Namur – Economics School of Namur – Rempart de la Vierge 8, 5000 Namur

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Abbreviations

IF Inclusive framework

G20 Group of Twenty

OECD The Organisation for Economic Cooperation and Development

EU The European Union

BEPS Base Erosion and Profit Shifting

TFDE Task Force on the Digital Economy

ETR Effective Tax Rate

IIR Income Inclusion Rule

UTPR Undertaxed Profit Rule

UPE Ultimate Parent Entity

CBCR Country By Country Report

MNE Multinational enterprise

DST Digital Services Tax

I. Introduction

Context and justification of the research

Like every major economic revolution, the digitalisation of the world has changed the global economic model as well as the way value is created.

The industrial revolution made it possible to mechanise production, electrification and the increasing automation of activities made it possible to increase production capacity tenfold and profoundly changed the place of man in the industrial process. Like these great revolutions, the digitalisation of the economy is redefining the notion of borders and increasing the dematerialisation of activities.

The digitalisation of the economy has also increased the role of the consumer in value creation. In the same way that it has revolutionised the process of production and value creation, digitalisation has made obvious the obsolescence of the century-old principles of taxation in the global economy.

These provide for international and inter-jurisdictional taxation based on a physical concept and require a material link between the place of production of the value and the jurisdiction wishing to tax. It is obvious that the dematerialisation of activities associated with the digitalisation of the economy raises new challenges in this respect. The advent of artificial intelligence and social networks has pushed the digital world to the forefront and brought with it the challenges that go with it.

These challenges and legal gaps have prompted national and global organisations in a second phase to legislate to provide a satisfactory legislative framework that best meets the challenges of taxation in the digital economy.

Objectives of the research

This contribution aims to highlight recent national and international contributions to the taxation of the digital economy. In this respect, this paper is an opportunity for us to focus on the international responses developed to address the new problems of international taxation and the existing gaps between different national legislations.

It aims to focus on the major project in this area, the OECD's (Organisation for Economic Cooperation and Development (hereafter, OECD)) Inclusive Framework (hereafter IF).
The ambition of this contribution is therefore to understand what novelties are brought by this legislative instrument. Similarly, it targets to consider how these innovations respond to the challenges brought by the digital economy.

We do not pretend to provide the solution to this global problem, but our contribution will be an opportunity to provide a synthetic and global view of the situation. It allows readers to dive into the issue of taxation of the digital economy and to have a summary of it.
Furthermore, we aim to focus on a theoretical approach to the situation. There is still too little data on the application of the IF to gather real results.
We will also focus on direct taxation, leaving aside indirect taxes such as VAT and excise duties.

Methodology

First, we will look at what the digital economy encompasses and why it should be taxed. Then we will focus on the IF. We will describe how it works and the various innovations it brings. We will also see why national responses to the taxation of the digital economy, such as digital services taxes, are not sufficient.
After analysing the IF in detail, we will describe its weaknesses and the disputes surrounding it.
Finally, we will look at the future of this legal construct and what will change with the latest OECD discussions on this subject.

In this report, we have taken a rather descriptive approach to presenting the content of the IF. However, we have taken a more relevant and critical approach by focusing on the salient and sensitive points it raises.
Because this subject is evolving so rapidly and to provide readers with simplified access, most of the sources we have used are available in electronic format.

II. The digital economy and tax challenges

A. What does the digital economy englobe?

At first, we need to describe and precisely delimit the outline of this concept. As there are plenty of definitions as this subject passionate many authors and because of its unclear boundaries, it is difficult to make one definition universal.
However, we choose the one developed by the Group of Twenty (hereafter, G20) because of its comprehensiveness and its ability to cover a lot of situations.
Furthermore, many countries have settled to use this meaning giving it an international dimension. That is why we will circumscribe the digital economy as "a broad range of economic activities that include using digitised information and knowledge as the key factor of production, modern information networks as an important activity space, and the effective use of information and communication technology as an important driver of productivity growth and economic structural optimisation[1]".

The early days of digitisation were primarily about the information and communication industry[2]. Then, a few sectors have been influenced by the spreading of digital technologies. The digitalisation is nowadays known as a global concern which affects all sectors of the economy in some way. It has created new sectors like social networks and blockchains but traditional sectors (information sectors, commerce, travel, and tourism industry…) have also been profoundly changed by the digitalisation of the economy. The digitalisation has also modified the way the value is created.

Because it has rapidly spread to all sectors of the economy, it is increasingly difficult to circumscribe the digital economy to a single definition.
The digitalisation of the economy has not only transformed goods and services but has also changed the environment around them. Advertising and marketing campaigns have also

[1] Ministry of Foreign Affairs of Japan (2019), "G20 Digital Economy Development and Cooperation Initiative (Final)", https://www.mofa.go.jp/files/000185874.pdf, accessed in March 2023.
[2] Okhunov Dilshod Mamatzhonovich, Okhunov Mamatjon Khamidovich, and Minamatov Yusupali Esonali o'g'li (2022), "DIGITAL ECONOMY: ESSENCE, FEATURES AND STAGES OF DEVELOPMENT", *Academicia Globe: Inderscience Research*, vol. 3, no. 04, p. 356.

become digital and have expanded extremely rapidly with the advent of social networks and new means of communication.

The digital economy is known as one of the most and fastest-growing sector all over the world. It has been characterised by rapid development all over the world.
We can see its expansion by looking at the share of the GDP represented by the digital economy. It has risen from 7,3% in 2005 to 9,0% in 2018[3].
Its real value-added followed a growing pattern of around 7% on average from 2006 to 2018[4].
By 2021, e-commerce was worth some $4.5 trillion and has been expanding steadily since the 2010s[5].
Moreover, a large proportion of the biggest corporates in the world are linked to the digital economy, and with the expansion of cryptocurrencies, NFT, AI software, their number will continue to grow.

Unfortunately, the digitalisation of the economy is also increasing inequalities. Disparities between countries that have embraced digitalisation and developing countries that are struggling to keep up with it risk increasing the menace of a two-speed world. According to the United Nations Conference on Trade and Development, only 20% of citizens of developing countries use the internet[6]. At the same time, 89% of European citizens used it in 2019[7].
The digitalisation of the economy raises many ethical questions. It can also pose a trade-off between efficiency and economic growth and the protection of weak populations.

We have used data to show the expansion of the digital economy. One may forget that it is obvious that the figures used depend on the definition given to the digital economy. The broader the definition, the more likely it is to encompass larger areas and the more inflated the figures will be. Hence, this is why we needed a global definition to provide means of comparison.

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[3] Nicholson, Jessica R. (2020), *New Digital Economy Estimates*, at 2, BUREAU OF ECONOMIC ANALYSIS, p.3.
[4] *Ibidem.*
[5] Osman, Maddy (2023), "Statistiques sur le eCommerce pour 2023 – Chatbots, Voix, Marketing Omni-Channel.", Kinsta, https://kinsta.com/fr/blog/statistiques-ecommerce/, accessed in March 2023.
[6] United Nations Conference on Trade and Development (UNCTAD) (2021), "Digital Economy Report 2021: Overview.", https://unctad.org/system/files/official-document/der2021_overview_en_0.pdf, p.xvi.
[7] Branimir, Markovic, Domagoj, Karacic, Mario Raic (2019), "THE DIGITAL TAX – WHY AND WHEN?", *Economic and Social Development: Book of Proceedings*, p. 107.

In the end, we note that the digitalisation of the economy is a vast subject that raises both hopes and concerns. New challenges are emerging, and international institutions are busy solving them.

B. The case for taxing the digital economy.

Like all areas that have undergone extremely rapid expansion, the digital economy must be fitted in a legal framework and political decisions must be taken to regulate its functioning. Just as it is important to provide a secure environment for its development, it is necessary to introduce a fair and efficient taxation system.
Institutions and legal frameworks were slow to respond to this all-new field. Furthermore, the problem is not always solved once laws or regulations have been voted because of the constant evolution of the system. As an example, Europe had to wait until the early 2000s to have a satisfactory law dealing with the liability of online platforms, the so-called e-Commerce Directive[8].
It has recently been deemed outdated because of its inability to respond to the evolution of e-Commerce.

At first sight, this directive was the perfect example of a revolutionary legal act. Thanks to this, European institutions know that they need to work on a piece of legislation that is sufficiently abstract to be adaptable to many situations and avoid having to amend the original text many times.

1. The taxation of the traditional economy

In the traditional economy, "usual" firms (shops, lawyers, food stores…) are taxed where they make the profit. For example, a shoe salesman will be taxed on the profits he makes in Belgium, namely where the value is created. Consequently, firms are subject to the tax rate of the country where they create the value.

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[8] Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market ('Directive on electronic commerce'), *Official Journal* L 178, 17 July 2000.

In the European Union, company taxation is a state competence[9]. Therefore, each European country determines its tax rate. For example, the nominal corporate tax rate in Belgium is set at around 25% since 2020, and the tax reform[10]. Quite logically, having different tax rates leads to tax competition between member states to attract firms and encourage them to establish in their jurisdiction. In extreme situations, competition between states could lead to extremely low taxation rates used to attract firms. In the end, it could give unwanted power to multinational companies. Tax competition is a major problem that disrupts the ability to tax companies effectively.
We will examine these issues further with BEPS problems.

On the international level, the basic principle of taxation is enshrined, *inter alia*, in Article 7 of the Model Tax Convention on Income and on Capital promulgated in 2017 by the OECD. It indicates how firms' benefits must be taxed and considers the possibility of international activities. According to this article, profits of a firm which is based in a Contracting State are only taxable in that State unless the firm conducts business in another Contracting State through a permanent establishment[11]. The comprehensive meaning of a permanent establishment is given by Article 5 of the same Convention. In other words, if a firm does not have a permanent establishment in another Contracting State, it will only be taxable in that country. The notion of permanent establishment focuses on the requirement of physical presence.

Because we have seen that taxation is a state competence, ensuring efficient taxation is no mean feat in Europe. Indeed, because it is a union of many countries, it must conciliate efficient taxation at a national level with fair competition between member states while respecting the repartition of competencies and ensuring the realisation of main objectives like free flow of goods and services[12]. In the meantime, in everyone's interest, it is essential that EU member states find common ground to minimise tax competition. It leads to a situation that is unfavourable for all member states, to the benefit of multinationals.

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[9] Treaty on the Functioning of the European Union, art. 112.
[10] Loi du 25 décembre 2017 portant réforme de l'impôt des sociétés, *M.B.,* 29 December 2017.
[11] OCDE (2017a), *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD Publishing, Paris, art. 7.
[12] Fourçans André (1993), « Fiscalité européenne et efficacité économique », *Revue française d'économie*, vol. 8, n°2, p.46.

December 14, 2022, the Council of the European Union therefore adopted a directive ensuring a global minimum level of taxation (15%) for multinational enterprises (hereinafter, MNEs)[13]. It has been requested for a long time by many countries whose arguments are found in the second recital of the directive: « By removing a substantial part of the advantages of shifting profits to jurisdictions with no or very low taxation, the global minimum tax reform will level the playing field for businesses worldwide and allow jurisdictions to better protect their tax bases. »[14]. It is indeed crucial that big companies that can shift their profits to low taxation rates jurisdictions must face a minimum rate otherwise smaller companies that are unable to would be treated differently. Fair taxation for both small and large companies is paramount in Europe from a legal and economic efficiency point of view.

From the directive, we see that the European Union defends two main objectives: stopping base erosion and profit shifting to make sure that multinationals are taxed where the economic activities generating profits are performed and where value is created[15].

This directive provides the application of the statement made by the OECD on challenges arising from the digitalisation of the economy and its consequences on the taxation legal framework, and more particularly the application of Pillar Two[16]. They focused on the worsening of base erosion and profit shifting (hereinafter, BEPS) problems related to the digital environment.

BEPS problems are a worldwide issue that is treated by many organisations such as the OECD, the EU, and even the United Nations. According to the latter, BEPS refers "to tax planning techniques by companies that exploit gaps in international and domestic tax laws, as well as mismatches between domestic tax systems, to shift profits"[17]. BEPS activities are also known as aggressive tax planning activities.

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[13] Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union, *Official Journal of the European Union*, 16 December 2022.
[14] *Ibidem*, recital 2.
[15] *Ibidem*, recital 1-2.
[16] OECD/G20 (2021c), *Statement on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy*, OECD Publishing, Paris.
[17] United Nations Department of Economic and Social Affairs *(s.d.),* "The United Nations Tax Committee and Base Erosion and Profit Shifting.", United Nations, https://www.un.org/esa/ffd/tax-committee/tc-beps.html, accessed in March 2023.

From this definition, we see that a major condition for the existence of such problems is the presence of differences in tax legislation between countries. These are fostered by tax competition and the absence of a minimum tax rate.
Companies that can commerce across borders and bear the costs of relocating their headquarters can benefit from more advantageous rates by taking advantage of gaps in taxation rates. A famous example of this strategy is the localisation of Ryanair's headquarters in Ireland. This country ranks in the top 3 European countries with the lowest nominal rates with a rate of 12,5%. One can undoubtedly understand the airline's tax strategy. However, as the directive 2022/2523 will soon be implemented, Ryanair will face an increase of this rate by 2,5% to reach the minimum rate applied throughout the European Union, 15 %.

The issue is not so much the transfer of profits as such. Indeed, it is possible that a company conducts the bulk of its activities in one country and shifts the profits it has made in other countries to the first one. From an ethical point of view, as far as the activities managed in other countries are limited in comparison to the activities steered in the home country, it could be justified to shift profits.
However, shifting profits becomes more problematic when it turns out that the jurisdiction in which the firm is located has little to do with the activities it carries out and that the firm is located there only to benefit from preferential rates.

Economist Gabriel Zucman was recently awarded the John Bates Clark Medal for his work analysing the impact of tax evasion on government revenues. He conducted several studies that revealed the scale of it. For instance, at the micro level, tax evasion accounts for 8% of global household financial assets. These assets go to tax havens such as Luxemburg, Hong-Kong or Switzerland. These studies take us right to the heart of the issues raised by the BEPS activities.
These findings are even more striking given that it is based on a minimum estimate of tax evasion figures[18]. That said, the most important point is to look at the microeconomic consequences that these increasingly elaborate and discreet tax arrangements have on international taxation. According to Mr Zucman, losses were in the region of 155 billion euros in 2016[19].

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[18] Zucman, Gabriel. (2017), *La richesse cachée des nations*, Deuxième édition, revue et augmentée, p. 32.
[19] *Ibidem, p.35.*

At company level, tax evasion is encouraged by disparities in tax rates and the increase in foreign direct investment. Throughout this contribution, we will have the opportunity to assess the impact at the macroeconomic level.

2. The specificities of the digital economy

With BEPS problems, we just get into the big problem of taxing the digital economy: across the border and de-materialised activities. The main issue arising from the traditional tax law is the notion of permanent establishment referred to in Article 5 of the above-mentioned OECD Convention. As we have seen, this notion includes a material element, the need of having a fixed place of business. For instance, that could be a place of management, a branch… One typical example is a car brand that has several dealerships around the world selling its vehicles.

This will be more and more difficult to conciliate this traditional framework with the numerical environment. Indeed, unlike traditional sectors, the digital economy does not necessarily require a physical presence to develop its activities. The link with physical activities is not as marked as in other sectors. The digitalisation allows companies to avoid having a physical presence in different jurisdictions which also means avoiding paying taxes under the traditional legislative framework.

These considerations worsen the probability of BEPS issues because, without permanent establishment, firms are only taxable in the country where they are principally based[20]. In an extreme situation, digital firms could establish their headquarters in a jurisdiction with a low taxation rate and conduct the bulk of their activities in higher rate countries while shifting all their profits to the low tax rate jurisdiction[21]. For these purposes, a company has two main opportunities for tax base erosion and profit shifting. It can either locate its activities or part of them in a low-tax country, or it can manipulate its financial operations so that profits are deemed to be generated in the latter country[22]. In the traditional economy, changing the location of activities involves transport costs that reduce efficiency. This is why the second option is generally preferred.

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[20] OCDE (2017a), *Model Tax Convention on Income and on Capital*, *op.cit,* art. 7.

[21] EL YAMLAHI , I., H. EL GHAZLANI, A. N. BOUAYAD, et K. ROUGGANI (2022), « Révolution Fiscale à l'ère Du BEPS : Enjeux Et défis De La Taxation De l'économie numérique », *Revue Française d'Economie Et De Gestion*, vol. 3, nº 5.

[22] Hindriks, Jean, and Gareth D. Myles, *op.cit.,* p.711.

The concept is straightforward: the affiliate, who is based in a low-tax jurisdiction, sells its services at an unreasonably high cost to the entity located in the higher-tax jurisdiction (these services are generally linked to the tertiary sector, i.e., legal services, management services, etc). In the end, profits are generated in the low-tax jurisdiction (tax havens such as the Bahamas, the Virgin Islands, etc.) and no profits are taxed in the higher-tax jurisdiction. This technique is called the manipulation of transfer prices[23].

Zucman rightly points out that this technique will be considerably enhanced with the advent of the digital economy. Indeed, it will be increasingly difficult to assess whether products and services sold at exorbitant prices by affiliates are being used for transfer pricing manipulation, as the value of these services has become so difficult to estimate. The digital economy brings with it intellectual property, the notion of creation and subjectivity, and overall immaterial capital making this task almost impossible[24]. Furthermore, in the digital economy, the transport costs associated with changing the location of activities are less significant due to the dematerialisation of activities, so that the first option regains its importance and further increases the problems associated with BEPS.

The notion of permanent establishment does not follow the evolution of the digital economy. We need to modernise the legal system to take account of the changing economy. It can be done either by reforming the actual system or by developing a brand-new system specially for the digital economy. Because it is increasingly difficult to distinguish between the digital economy and the traditional economy as digital has expanded, nor should a separate regime be created.

We will see further that the absence of a permanent establishment is also an element that makes it more difficult to answer the question of where value is created and consequently where it must be taxed.

3. Why should the digital economy be taxed?

Few reasons justify that countries adopt a comprehensive legislative framework surrounding the taxation of the digital economy.

[23] Zucman, Gabriel. (2017), *op.cit.,* p. 76.
[24] *Ibidem.*

At first, BEPS issues raise a question of equity. Under traditional principles of international taxation, firms and companies that can shift their profits to low tax rates jurisdictions can benefit from lower tax rates and manage to avoid all taxes in some countries even if they develop their activities there. Indeed, they do not fall under the definition of permanent establishment thanks to the dematerialisation of their activities.
In contrast, even if they can institute their headquarters in a low-tax jurisdiction, traditional firms that require a physical presence (permanent establishment) cannot escape paying taxes in other countries where they conduct activities. As an example, a fashion brand that is based in Sweden would be taxable in other European countries because it needs to have shops, or in other words, a permanent establishment, to ensure the sale of its products.

The actual framework advantages digital companies. Some companies have an almost zero tax rate[25]. Following a European survey, digital companies are taxed based on an effective tax rate of 9.5% on average while traditional companies are taxed at a rate close to 23%[26].
In addition to these intersectoral discriminations, there are also differences in taxation rates between international digital companies and national digital companies[27]. International companies can shift their profit to low rates jurisdictions while national companies cannot.
Because of these gaps in effective tax rates, firms that pay their taxes may be discouraged from participating in the collective effort and practice tax evasion. This reasoning can also be applied to individuals. Why would they continue to pay their taxes if they know that big companies can shift their profits and escape taxation legally? The risk is to exacerbate tax evasion by individuals and lose the support of the population in the collective effort. We can draw a parallel with reasoning that we often hear in the fight against global warming: why should I make an individual effort that will have very little impact while large companies continue to pollute for the equivalent of millions of inhabitants?

Therefore, that is a clear discrimination according to the fact that digital companies have access to a market with millions of consumers and can raise millions of euros without or nearly without being taxed.

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[25] European Commission (2018), "Questions et réponses sur un système d'imposition des entreprises juste et efficace au sein de l'Union pour le marché unique numérique.", https://ec.europa.eu/commission/presscorner/detail/fr/qanda_18_1683, accessed in February 2023.
[26] *Ibidem.*
[27] EL YAMLAHI, I., H. EL GHAZLANI, A. N. BOUAYAD, et K. ROUGGANI (2022), *op.cit.*

Then, taxing the digital economy would be a great source of revenue for countries. In 2017, the realisation of the digital unique market was estimated to represent a potential of over 415 billion dollars for the EU economy[28]. Because of the permanent expansion of this economy, this amount is not likely to decrease. This area sounds like an unexploited element of the member states' taxation potential. Amounts raised on this basis could be used to finance government expenditures. It may not happen soon, but effective taxation of digital companies could help reduce the tax burden on individuals.

With the expansion of cryptocurrencies, economic activities that will be undertaken in digital currencies will increase and profits generated will do so. One can see this as new activities that could be taxed. But from another point of view, one can see traditionally taxed activities that now escape taxation because they have been dematerialised. An obvious example is the multimedia environment. Previously, we had to go to the cinema or buy or rent a DVD to watch a film. Consequently, there was a material notion of an establishment offering these kinds of activities allowing the taxation of it. With the expansion of streaming platforms, this leisure activity has become almost totally dematerialised and the taxation of these activities has become more complicated.

Furthermore, without having an efficient tax, we do not make sure that everyone contributes to the funding of government expenditures. Digital companies and MNEs benefit from public facilities (such as the internet, and telephone networks...) and rights and protection of many legal systems. Providing such installations has a cost and anyone that uses it must contribute to its funding.

As we are writing this contribution, we use Google to collect information, data platforms to have access to a large panel of data, Universities' platforms, etc. The bulk of these platforms collect our data and sell or use them for marketing purposes. Sometimes, users of such platforms do not even know that their data are used by them. However, platforms generate profits with such activities that must be taxed.

[28] European Commission (2017), "Un système d'imposition juste et efficace au sein de l'Union européenne pour le marché unique numérique.", https://taxation-customs.ec.europa.eu/fair-taxation-digital-economy_fr, accessed in February 2023.

Finally, and more essentially, a global tax system with a minimum tax rate could tackle BEPS issues. By regulating activities in countries other than the one in which the companies are based, we prevent profit shifting to a low-rate jurisdiction because it makes it less attractive to establish headquarters in these jurisdictions. This is exactly the reason that has justified the introduction of the notion of permanent establishment in the traditional corporate taxation framework. According to the OECD and the G20, BEPS activities are a lack of revenue for countries of around 100-240 billion dollars each year[29].

Tackling BEPS activities is paramount in high tax burden countries like Belgium. In these countries, the state takes care of many areas of its citizens' lives such as an efficient social security system, education, health care, pensions... They are described as "welfare states" and taxes are crucial for the survival of their citizens. These states are, by their nature, inherently more affected by tax evasion and therefore more easily discriminated against by two-tier taxation.

III. International responses to taxation of the digital economy: The OECD example

A. The limits of national initiatives

Some European countries have implemented a digital services tax (hereinafter, DST) or have proposed or shown intentions to do so[30]. They aim to specifically address the taxation of these services. They have generally been developed by these countries to respond quickly to the challenges outlined above.

However, it turns out that national responses will not be enough to tackle the problem. We have seen that different national taxation rates could lead to profit-shifting issues.

Because of its multinational and across-boundaries dimension, taxation of the digital economy requires international responses. That is the only solution to close the gaps arising from national decisions about corporate taxation.

[29] OCDE (2021a), *Economic Policy Reforms 2021: Going for Growth: Shaping a Vibrant Recovery*, OECD Publishing, Paris.

[30] Bunn, Daniel and Asen, Elke (2022), "What European Countries Are Doing about Digital Services Taxes.", *Tax Foundation*, https://taxfoundation.org/digital-tax-europe-2022/, accessed in February 2023.

Furthermore, an international framework and multilateral agreements are crucial to avoid double-imposition issues and vice versa, international rules are needed to avoid double exemption from taxation.
As we said before, the digitalisation of the economy worsens the tax competition. Because of the huge amounts of money generated by the digital economy, countries are increasingly tempted to lower their tax rates to attract businesses to their jurisdiction.

Big problems call for big solutions, in Europe, EU institutions are required to propose a unique strategy that addresses the major challenges raised by the digitalisation of the economy. Moreover, the European Union has the power to create a harmonised legal framework and has the clout to take on the digital giants.
Then, if the EU wants to realise one of its prime objectives, the digital single market, we will need to have a harmonisation on tax rates. “A Europe fit for the digital age” consists in a digital single market that allows the EU to make its digital transition[31].
One should not forget that fiscality and corporate taxation are state competencies in the European Union. That does not prevent the EU to take measures to introduce a minimum tax rate or change the definition of permanent establishment. In the end, EU institutions have a significant margin of appreciation on the subject.

The necessity to tax the digital economy no longer needs to be proved. Nevertheless, the way the system should be modernised is yet to be chosen. The solution that increasingly seems to be emerging is a modernisation of the current legislative framework rather than the creation of a separate system[32]. It is indeed desirable from a logical point of view. This avoids adding again a legal act leading to a loss in clarity, legal certainty, and credibility in the legal framework. This does not prevent a special regime from being applied to certain areas of the digital economy. Because of its specificity, it is sometimes impossible to have a general and abstract regulation applicable to all taxation.

We have just seen that BEPS activities are the main arguments that justify an international reaction. Let us remind that BEPS practices are not a challenge specific to the

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[31] European Commission (2020), "Europe fit for the Digital Age.", https://ec.europa.eu/info/strategy/priorities-2019-2024/europe-fit-digital-age_en, accessed in February 2023.
[32] European Commission (2018), *Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence*, COM (2018) 147 final.

digital world, it affects the traditional taxation scope as well but because BEPS problems are worsened by digitalisation, we will focus on them in this context.

B. OECD's response to the challenges raised by the digitalisation of the economy, the inclusive framework.

As briefly said before, the OECD, in close collaboration with G20, has worked on an assessment on the challenge arising from the digitalisation of the economy: the OECD/G20 Inclusive Framework on BEPS[33]. It is a legal instrument that has been accepted by around 140 member jurisdiction, at the time of writing, and has resulted in an agreement on international tax rules[34].

Having many signatories is crucial. The application of this legal instrument in many countries is what gives it strength at the international level.

The framework was prepared in 2015, but the OECD had been working on it for a long time. One should not forget that this legal act is in constant evolution. Actually, the OECD and the G20 post, each year, statements about the evolution and decisions that are made about the digital economy.

In the context of international tax competition, this framework is the result of multilateral agreements and efforts, and such creation would be impossible without international cooperation. We have seen that without an international agreement, the taxation could lead to a prisoner's dilemma. All countries would benefit from the application of a higher and minimum tax rate but in the absence of an international and coercive instrument, each country would have an interest in lowering its rate to attract business, resulting in a race to the bottom[35]. In the end, we would end up with almost zero rates. In this regard, international cooperation is essential.

This cooperation is crucial for the creation of this framework but also for its implementation. We will see that the rules are such that they require an international exchange of data and a high degree of transparency.

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[33] OECD/G20 (2021c), *Statement…*, *op.cit.*

[34] OECD (2020a), *Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

[35] Hindriks, Jean, and Gareth D. Myles. *Intermediate Public Economics*. The MIT Press, 2013. *JSTOR*, http://www.jstor.org/stable/j.ctt5hhchq. Accessed July 2023, p.685.

This framework is the first major reform of the international tax rules since the 1920s and the U.S. international tax law[36]. It follows the adoption, in September 2013, of a 15-points Action program used to prevent MNEs to conduct BEPS activities[37].

The IF is based on a two-pillar approach to address problems arising from the digitalisation of the economy. As a reminder, although discussions and first agreements were adopted in 2013-2015, the key developments and the framework as we know it today were introduced in 2021. In this regard, the OECD major contribution to the challenges arising from the digitalisation of the economy is undoubtedly the "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy" promulgated on 8 October 2021. This is mainly what we will refer to when we talk about the IF.

Each pillar aims at addressing gaps in international taxation rules that are used by MNEs to avoid paying taxes[38]. That is the mere definition of BEPS activities. The idea behind the fight against BEPS activities is that profits generated by digital businesses must be reported where they are created (i.e., where the generating activities take place) and where the value is created[39]. In other words, this framework aims to ensure that all international businesses are taxable at a minimum rate and in the countries in which they develop their activities and generate profits[40]. The goal is to make sure that all MNEs contribute fairly and effectively to taxes regardless of their place of establishment and the nature of their activities.

One should not forget that it is essential that taxation remains a national competence and that the national sovereignty in this area must be respected. In this context, we remind that Pillar One and Pillar Two do not replace any tax rules but complement them[41]. However, we

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[36] Graetz, Michael J., and Michael M. O'Hear (1997), "The 'Original Intent' of U.S. International Taxation.", *Duke Law Journal*, vol. 46, no. 5, p.1024.

[37] OECD (2015b), *Transfer Pricing Documentation and Country-by-Country Reporting*, Action 13 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p.3.

[38] OECD (2022c), "Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy Frequently asked questions.", OECD, July 2022, https://www.oecd.org/tax/beps/two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-frequently-asked-questions-july-2022.pdf, accessed in February 2023.

[39] OECD (2015a), *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

[40] OECD (2020b), *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

[41] Hanlon, Michelle and Nessa, Michelle L. (2023), "The Use of Financial Accounting Information in the OECD BEPS 2.0 Project: A Discussion of the Rules and Concerns" (October 25, 2022) Forthcoming, *National Tax Journal*, vol. 76, no. 1, p. 1973.

will see a major exception to this principle in the form of the requirement to remove existing DSTs.

The first pillar aims at establishing the taxation where activities are conducted, and where profits are generated and the second provides a global minimum tax rate. We can also notice an important difference between the two pillars is their scope. Pillar One affects fewer companies than the second one because of the difference in the precision of their application range.

1. Pillar One:

   a. Scope

The first pillar targets the largest companies. It has been developed to stop the biggest companies in the world avoiding paying any taxes. Companies that are targeted by the first pillar are multinational enterprises that generate a turnover above 20 billion euros and that have profitability above 10 %, which is calculated by dividing the profit by the turnover[42].
The scope should be adapted by 2028 to include more companies in Pillar One by reducing the minimum turnover to 10 billion euros[43].
Revenues and profits linked to extractives and financial services are excluded from Pillar One [44].

In the early days of the introduction of the first pillar, it was discussed to target only two activities (in-scope activities): automated digital services and consumer-facing businesses[45]. It should be noted that in the statement which came into force in October 2021, the scope was no longer limited to these activities.

   b. Goal:

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[42] OECD/G20 (2021c), *Statement…*, *op.cit.*
[43] European Commission (2021), "Global Agreement on Corporate Taxation: Frequently Asked Questions.", https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_3564, accessed in February 2023.
[44] OECD (2022a), "FACT SHEET AMOUNT A Progress Report on Amount A of Pillar One ." OECD/G20 Inclusive Framework on BEPS, https://www.oecd.org/tax/beps/pillar-one-amount-a-fact-sheet.pdf.
[45] OECD (2020b), *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint*, *op.cit, p.19.*

The goal is to adapt the existing rules and make them applicable to the biggest companies that do business without a physical presence[46]. However, this is not the main objective. Indeed, these companies are already taxed in low jurisdiction. In fact, the main goal of the first pillar is to redistribute profits to countries in which profits and activities are conducted without being the jurisdiction in which the company is located (i.e., countries in which consumers and users of these MNEs are located)[47]. These are market jurisdictions that will be able, with the application of the first pillar, to tax excess profits[48]. In this respect, it creates a brand-new right to tax for market jurisdictions. As an example, Belgium has a quite high corporate tax rate and is a big market for digital companies. Therefore, it could benefit from the application of the first pillar.

c. Binding force:

Pillar One is binding for all participant countries or jurisdictions as it is translated into a multilateral convention[49].

d. Impacts:

The application of the first pillar is expected to reallocate around 125 billion dollars to market jurisdictions. This is a piece of particularly good news for countries that do not have many company headquarters but are big markets for digital activities[50].

We will see that the first pillar is divided into three sections that regulate the reallocation of excess profits to market jurisdictions.

It is estimated that Amount A (the main section of Pillar One) is likely to provide a reallocation of around 87 billion dollars. It is important to note that 45% of this total amount is generated by technology companies[51].

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[46] European Commission (2021), "Global Agreement on Corporate Taxation: Frequently Asked Questions.", *op.cit.*

[47] OECD (2021b), *OECD/G20 Base Erosion and Profit Shifting Project Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, OECD Publishing, Paris, p.4.

[48] KPMG (2023), "Taxation of the digitalized economy Developments summary Updated: February 7", p. 34, https://kpmg.com/xx/en/home/insights/2019/06/tnf-digital-economy0.html, accessed in February 2023.

[49] European Commission (2021), "Global Agreement on Corporate Taxation: Frequently Asked Questions.", *op.cit.*

[50] OECD (2020a), *OECD/G20 Base Erosion and Profit Shifting Project*, *op.cit.*, p.5.

[51] Devereux, Michael, and Simmler, Martin (2021), "Who Will Pay Amount A?", *EconPol Policy Brief 36*, ifo Institute - Leibniz Institute for Economic Research at the University of Munich, p. 1.

e. <u>The allocation of excess profits to market jurisdictions</u>

The lack of physical presence makes the issue of taxation difficult and complicates the allocation of profits between the market jurisdiction and the jurisdiction of establishment. The OECD had to create a whole new system of taxation that can link the profits created on a territory in the absence of this notion of physical presence.

In this regard, the first pillar distinguishes between three blocks that deal with the taxation of profits by market jurisdictions: Amount A, Amount B and Tax Certainty[52]. These amounts are without prejudice to the amounts collected in the jurisdiction of establishment. They are residual. This is an application of the principle of national sovereignty in tax matters.

i. <u>Amount A:</u>

Amount A, which is based on a multilateral convention (MLC), seeks to allow market jurisdictions to tax a portion of profits made by companies that fall within the scope of the first pillar. That means that companies that meet the required profitability and revenue thresholds are subject to Amount A.

It introduced a brand-new tax right for market jurisdictions (i.e., jurisdictions in which consumers and users are located) and new nexus rules have been developed to enable market jurisdictions to tax residual profits.

The application of Amount A involves redistributing 25% of a multinational enterprise's residual profit, exceeding 10% of its revenues, to market jurisdictions in which the company meets certain criteria (principally nexus condition)[53]. The formula and the calculation of residual profits will rely on published consolidated financial accounts[54].

They have introduced two approaches to calculate the profits relocatable to the market jurisdiction. The quantum of Amount A can either be calculated by using absolute amounts of profit, this is the “profit-based approach”, or by using profit ratios, the “profit-margin-based approach”[55].

As mentioned before, a new nexus rule will be introduced, which will allow the allocation of Amount A to a specific market jurisdiction. This is possible if the multinational enterprise

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[52] OECD (2020b), *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint*, *op.cit*, p.12.
[53] OECD/G20 (2021c), *Statement…*, *op.cit.*, p. 2.
[54] OECD (2020b), *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint*, *op.cit.,* p.14.
[55] *Ibidem.*

(MNE) generates revenues of at least €1 million in that jurisdiction. For smaller jurisdictions, with a GDP of less than €40 billion, the minimum revenue requirement will be reduced to €250,000[56].

This allocation is subject to adjustments under the marketing and distribution profits safe harbour and will be based on the amount of revenues generated in those jurisdictions using specific revenue-sourcing rules[57]. That could happen if the residual profits are already taxed in a market jurisdiction.
Revenues generated from the sale of goods or services will be attributed to the jurisdictions where those goods or services are ultimately used or consumed[58].
Amount A rules will work conjointly with existing profits allocation rules. It is important to understand that these amounts are in addition to the existing rules and are not *a priori* intended to replace them.

Amount A includes a mechanism to reconcile any divergences and avoid double taxation. It develops a dispute prevention system and resolution mechanisms[59]. In this context, it enhances tax certainty. The risk of double taxation is particularly important when talking about multinational groups and related entities. This discussion will be the subject of point iii.

Because contracting states will need to amend their domestic law to comply with the requirements of Amount A, the IF has set up a cell that is responsible for providing a model for implementing the rules developed by this same Pillar. This responsibility is given to the Task Force on the Digital Economy (TFDE)[60].

ii. Amount B:

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[56] OECD/G20 (2021c), *Statement…*, *op.cit.*, p.1.
[57] *Ibidem*, p.2.
[58] *Ibidem*, p.2.
[59] *Ibidem*, p.2.
[60] Spencer, David E. (2022), "OECD/G20: Inclusive Framework Statement.", *Journal of International Taxation*, vol. 33, no. 1, p.25.

The fundamental objective of Amount B application is to simplify and modernise the arm's length principle. It does not imply big changes but tends to clarify the application of this old principle[61].
The arm's length principle is an old-fashion principle used to estimate transfer pricing. It is defined by the Article 9 of the OECD Model Tax Convention. It provides that we must take the price of the transfer as "it is the price that would be paid for similar goods in similar circumstances by unrelated parties dealing at arm's-length with each other"[62].
For the sake of brevity, we will not elaborate on the subject.

iii. Tax Certainty:

A comprehensive document has been created to improve the legal certainty surrounding the application of Amount A[63]. It introduces a brand-new system responsible for resolving conflicts of application of Amount A.

It is paramount to provide a satisfying dispute settlement because Amount A tends to reallocate a portion of the residual profits from one jurisdiction to another. The application of Amount A is no mean feat and could lead to errors that should quickly be resolved. On the other hand, legal certainty strengthens the feeling of adherence to the rule of law, which tends to increase its application by the public.

However, this is not the only element that contributes to the tax certainty. As a matter of fact, it is announced that all the rules surrounding taxation have been simplified and that the legal framework should allow for a smooth application. For example, the scope has been simplified and is based on a clear turnover threshold with a couple of exclusions. It should be remembered that a simple legal arsenal goes hand in hand with an effective settlement procedure.

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[61] OECD (2022e), *PUBLIC CONSULTATION DOCUMENT: Pillar One – Amount B*, OECD Publishing, Paris, p.7.
[62] Yao, Jen-Te (2013), "The Arm's Length Principle, Transfer Pricing, and Location Choices.", *Journal of Economics and Business*, p. 2.
[63] OECD (2022d), *PUBLIC CONSULTATION DOCUMENT: Pillar One – A Tax Certainty Framework for Amount A*, OECD Publishing, Paris. p.5.

More importantly, it is the implementation of this IF that improves legal certainty. Indeed, it prevents the existence of gaps in national rules and provides a unique harmonised set of rules. In this way, it decreases the risks of double taxation.

The OECD has also provided a mechanism that allows companies to be sure that the instruments used to calculate their turnover are adequate. In this way, companies are assured of proper compliance[64].

2. <u>Pillar Two:</u>

The second pillar is also referred to as the "anti-Global Base Erosion" (GloBe)[65]. GloBE rules are divided between different chapters.
It is generally known as the major action that tends to tackle BEPS activities. It aims at providing a global minimum tax rate.

a. <u>Scope:</u>

We can find the scope of the second pillar in Chapter 1 of the Pillar Two Model Rules[66]. As for the first pillar, the scope of the second pillar uses amounts denominated in euros. For the sake of flexibility and to avoid making the system obsolete too quickly, amounts expressed in euros can be denominated in other currencies by using harmonised foreign exchange translation rules and amounts can be modified to take account of contemporary economic factors[67].
As we said, the scope of the second pillar is much broader than that of the first. Any company with over 750 million euros of annual revenues is covered by Pillar Two and is subject to a global minimum corporate tax rate in each jurisdiction where they conduct activities[68]. In contrast to Pillar One, Pillar Two does not have a profitability threshold to fall within its scope.

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[64] OECD (2022e), *PUBLIC CONSULTATION DOCUMENT: Pillar One – Amount B*, *op. cit.*, p.6.
[65] OECD (2020b), *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint*, *op.cit.,* p.8.
[66] OCDE (2021a), *Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p.8.
[67] OECD (2023c), *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, OECD/G20 Inclusive Framework on BEPS, OECD Publishing, Paris, p.9.
[68] OCDE (2021a), *Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)*, *op.cit.,* art. 1.11.

All the sectors of the economy are englobed in the scope[69]. This contrasts with Pillar One which excludes extractives and financial services from its scope.
However, some companies may be exempted from the application of this pillar. They are generally exempted in consideration of their purposes (their social object). In this sense, the following are not covered: Non-profit Organisations, Government Entities, International Organisations…[70]
The members of the IF are free to adopt GloBE rules, but they also can apply an additional tax to a parent entity that is linked to a constituent entity that benefits from a low-taxed income, even if the required threshold is not met[71].

b. Goal:

The goal of Pillar Two is to ensure that all MNEs pay a minimum level of tax on profits generated in the jurisdiction where they conduct activities and businesses[72]. Based on a consensus, the idea is to put a floor for the corporate tax rate. It is used to delimit a space for fair and equitable taxation. More fundamentally, it has been developed to challenge BEPS activities and limit corporate tax competition[73]. By introducing a minimum rate applicable in each jurisdiction in which a company makes a profit, profit shifting becomes less interesting. In this context, GloBE rules also aim to change the behaviour of jurisdictions. Indeed, tax competition was a consequence of the lack of a global consensus on company taxation. These practices had the consequence of pushing rates down, resulting in a brake on effective taxation.

The minimum tax rate (MTR) instituted by the OECD is set at 15%[74]. We have seen that EU institutions adopted a directive implementing this rate.

c. Binding force:

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[69] OECD (2022c), "Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy Frequently asked questions.", *op.cit.*
[70] OCDE (2021a), *Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two), op.cit.*, art.1.5.
[71] European Commission (2021), "Global Agreement on Corporate Taxation: Frequently Asked Questions.", *op.cit.*
[72] OECD (2023c), *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), op.cit.,* p.9.
[73] Hanlon, Michelle and Nessa, Michelle L. (2023), *op. cit.*
[74] OECD (2020a), *OECD/G20 Base Erosion and Profit Shifting Project…, op.cit.,* p.4.

Rules developed by the second pillar (GloBe rules) take the form of a common approach. That means that the members of the IF are not required to adopt these rules. But as soon as they decide to do so, "they will implement and administer the rules in a way that is consistent with the outcomes provided for under Pillar Two"[75].

Even if they do not adopt the rules, they are required to accept "the application of the GloBE rules applied by other IF members including agreement as to rule order and the application of any agreed safe harbours"[76].

This is quite an interesting aspect of Pillar Two because this implies that MNEs will still be held accountable for the consequences of Pillar Two, even if their subsidiaries are located in countries where the operating rate is below the agreed minimum[77].

d. Impacts:

According to the OECD, the application of the minimum corporate tax rate is likely to generate about $150 billion in additional tax revenue on an annual basis[78].

Furthermore, introducing a minimum corporate tax rate and a global framework resolving taxation issues simplifies the digital legal environment and makes the rules understandable and predictable.

Depending on the country, the adoption of the second pillar could lead to a leak or mass influx of firms. In fact, jurisdictions with a low rate could lose their attractiveness.

Let us imagine a country with a particularly low corporate tax rate. Because of the dematerialisation of digital activities, firms have an interest to establish their headquarters in this jurisdiction. Nevertheless, now that a minimum rate is applicable, the fiscal advantage could lose all its influence in the location decision and firms could look at other considerations like the presence of qualified people, state-of-the-art infrastructures… Higher-rate jurisdictions could benefit from the application of this pillar.

e. The taxable base of the MTR

In the context of the application of the IF, it was concluded that profits should be preferred as the taxable base subject to the MTR.

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[75] OECD/G20 (2021c), *Statement…*, *op.cit.,* p.3.

[76] *Ibidem*, p.3.

[77] European Commission (2021), "Global Agreement on Corporate Taxation: Frequently Asked Questions.", *op.cit.*

[78] Hanlon, Michelle and Nessa, Michelle L. (2023), *op. cit.*

As we said before, Pillar One and Pillar Two do not replace existing corporate tax rules. Therefore, the application of the minimum tax rate is a challenging task. We need to combine the application of both sets of rules without creating a conflict of application.
The minimum tax rate set at 15% works as a top-up tax that is applied if profits generated in a jurisdiction are subject to a lower rate[79].

The question of whether a MNE is subject to a top-up tax and if so, how it is calculated is done in five steps[80].
We first need to know if the MNE falls within the application of Pillar Two. This question is treated by the Article 1.1 of the Global Anti-Base Erosion Model Rules (Pillar Two) (hereinafter GloBE Model rules). The first chapter of the mentioned Model provides the precise scope of the latter by specifying the groups and entities covered, adequately defining these terms, and citing the excluded entities and groups.

If the MNE or the constituent entity of a MNE group is subject to its application, we calculate the income, the basis for taxation.
The income that is subject to the top-up tax is called the Net GloBE income. It is calculated as follows: $Net\ GloBE\ Income = GloBE\ Income\ of\ all\ Constituent\ Entities - GloBE\ Losses\ of\ all\ Constituent\ Entities$[81].
We need to find the Net GloBE income for each constituent entity of the MNE group. The Net GloBE income is calculated using financial accounting information. The definition and the calculation of GloBE income, GloBE losses and the Net GloBE income are governed by chapter three of the above-mentioned model. Article 3.2.1 of the Model lists the different items that go into the calculation of Net GloBE income. For example, the company income must be adjusted for net taxes expense to arrive at the target income. We will see in more detail later what the concept of income and the real tax base of Pillar Two encompasses.

It is important to note that the top-up tax must be calculated only if profits are generated. That means that the Net GloBE income cannot be negative. Then if a MNE group is making

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[79] OECD (2023a), "Overview of the Key Operating Provisions of the GloBE Rules.", OECD, https://www.oecd.org/tax/beps/pillar-two-GloBE-rules-fact-sheets.pdf, accessed in March 2023.
[80] *Ibidem*.
[81] OCDE (2021a), *Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two), op.cit.*, art.5.1.

losses (i.e., if the Net GloBE income is negative), it will not be subject to this top-up tax. It is already clear that this requirement represents the Achilles heel of this legal construction.

Then, we calculate the effective tax rate (hereinafter ETR). Its definition is given by the Article 5.1 of the Global Anti-Base Erosion Model Rules (Pillar Two). The ETR of the MNE Group for a jurisdiction is understood to be “equal to the sum of the Adjusted Covered Taxes of each Constituent Entity located in the jurisdiction divided by the Net GloBE Income of the jurisdiction for the Fiscal Year” [82]. In other words, we can define it as the rate at which MNEs are actually subject.

After calculating the ETR, if it is below the minimum level of 15%, an additional tax will have to be applied to reach the rate prescribed by Pillar Two[83]. The idea is that the additional tax acts as a way of ensuring that the company is ultimately subject to an effective minimum rate of 15%. The calculation is made for each jurisdiction in which the MNE is subject to the application of Pillar Two.

The calculation of the tax is simply determined by applying the following formula: $Top\ up\ Tax\ Percentage = Minimum\ Rate - Effective\ Tax\ Rate$[84].

The procedure for calculating the tax percentage for a constituent entity is given in section 5.2.4 of the Model.

Two rules can justify the application of a top-up tax: the Income Inclusion Rule (hereafter, IIR) and the Undertaxed Profit Rule (hereafter, UTPR)[85].

The IIR aims at requiring the ultimate parent entity (hereafter, UPE) to pay the well-named top-up tax for all constituent entities that are subject to an ETR smaller than required (i.e., <15%)[86]. The definition of the UPE can be found in chapter one of the Model rules. This rule is also applicable to the intermediate parent entities of which a constituent entity (in which

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[82] *Ibidem*.

[83] Accountancy Europe (2023), "EU Pillar 2 Directive: Impacts on Businesses Ensuring a Minimum Level of Taxation with Global Anti-Base Erosion Rules (GloBE) Factsheet.", https://www.accountancyeurope.eu/wp-content/uploads/Globe-Fact-Sheet-FINAL-1.pdf, accessed in March 2023.

[84] *Ibidem*.

[85] OECD (2020c), *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p.114.

[86] OCDE (2021a), *Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two), op.cit,* art. 2.1.

it holds shares) is located in a jurisdiction with a lower tax rate. In this situation, the intermediate parent entity "shall pay a tax in an amount equal to its Allocable Share of the TopUp Tax of that Low-Taxed Constituent Entity for the Fiscal Year"[87].

The UTPR is applied if the UPE is not targeted by a qualifying IIR or if the parent entity is not subject to the top-up tax for other reasons[88]. It applies in a kind of residual way.

C. <u>International cooperation</u>

Because both pillars target firms on a turnover basis and because the bulk of the information comes from the private sector, it is paramount for countries to have access to a large panel of data and to be able to verify it. Furthermore, once the data and information have been collected, international exchange must take place and we need to enhance transparency.

For these purposes, the OECD makes international cooperation a priority. The international cooperation in the taxation framework is developed by the Action 13 of the Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan, OECD, 2013) (i.e., BEPS project)[89].

The first tool that has been implemented is the "Country by Country Reporting" (hereinafter CBCR)[90]. With this instrument, MNEs are required to provide a bunch of determined information about their financial position.
The following information must appear in the CBC report: aggregate information relating to the amount of revenue, profit (loss) before income tax, income tax paid, income tax accrued, stated capital, accumulated earnings, number of employees and tangible assets other than cash or cash equivalents, with regard to each tax jurisdiction in which the MNE group operates[91].

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[87] *Ibidem*, art. 2.1.2.
[88] Accountancy Europe (2023), *op.cit.,* p. 2.
[89] OECD (2022b), *Guidance on the Implementation of Country-by-Country Reporting: BEPS Action 13*, OECD Publishing, Paris.
[90] *Ibidem.*
[91] OECD (2017b), *Country-by-Country Reporting: Handbook on Effective Implementation*, OECD, Paris, p.17, www.oecd.org/tax/beps/country-by-country-reporting-handbook-on-effective-implementation.pdf., accessed in March 2023.

The OECD has developed a comprehensive guidance that answers important questions such as what should be included in the turnover, how is it calculated, how is the turnover made by an entity treated…[92] Companies have access to a standardised document that they must complete each year and for each jurisdiction[93].

As for the application of the second pillar, multinational companies with a combined revenue of above 750 million euros are subject to the CBCR requirement[94].

In the early days of the CBCR, it was agreed that all information that were provided by MNEs in the context of the CBCR would not be released to the public. As a matter of fact, jurisdictions have access to the reports but must ensure their confidentiality[95]. This can logically be justified as the CBCR provides a transnational exchange of sensitive information.
Nevertheless, the EU has adopted, at the end of 2021, a directive that ensures public CBCR[96]. In our opinion, this implementation may raise questions about the need to make sensitive information public. Is it necessary for the functioning of the IF? Information that are required through the report are extremely confidential. For instance, the turnover or profits can reveal some precious information about the firm such as its financial situation, the cost-benefit lever…

The main advantage of the CBCR is that jurisdictions have access to a comprehensive bunch of information and can understand how companies conduct their activities, and where they generate their profits. In this context, it is in theory way easier for countries to identify tax evasion and fiscal havens.

Many participating countries have introduced penalties for MNEs that do not fulfil their obligations[97]. It is important to note that each country is free to develop its penalties. For

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[92] OECD (2022b), *Guidance on the Implementation of Country-by-Country Reporting: BEPS Action 13*, *op. cit.*
[93] OECD (2017b), *Country-by-Country Reporting: Handbook on Effective Implementation*, *op.cit.,* p.9.
[94] Deloitte (2016), Country by Country Reporting: The FAQs, https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-country-by-country-reporting-faqs.pdf, accessed in March 2023.
[95] Hugger, Felix (2020), "The Impact of Country-by-Country Reporting on Corporate Tax Avoidance", *Austaxpolicy: Tax and Transfer Policy Blog,* https://www.austaxpolicy.com/the-impact-of-country-by-country-reporting-on-corporate-tax-avoidance/, accessed in March 2023.
[96] Directive (EU) 2021/2101 of the European Parliament and of the Council of 24 November 2021 amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches (Text with EEA relevance), © EUR-Lex, 01/12/2021, eur-lex.europa.eu, recital 2.
[97] OECD (2015), *Transfer Pricing Documentation…*, *op.cit,* p.19.

instance, Belgium has developed a two-level penalties system[98]. At first, companies that do not meet their requirements (no CBCR fulfilled, incomplete CBCR, or CBCR fulfilled after the deadlines) receive a notification. Then, if they still do not meet their obligations, sanctions may be imposed. Once again, there are two possible situations. If it is the first infraction and there was no intention to proceed to fiscal evasion, the penalty could be fixed to zero. However, for the following infraction, the penalty can range from 1,250 to 25,000 euros[99]. The amount collected as a penalty must be sufficiently high to act as a disincentive to infringement of the CBCR rules.

Since its introduction in 2016, the CBCR requirement has permitted countries to know exactly where the profits and activities of their MNEs have been developed. As an example, Germany has discovered that the activities conducted in European tax havens were way more profitable than the ones conducted in non-havens[100]. This may seem quite logical, but it is nevertheless important information for countries in their tax policy strategy.
Moreover, more and more countries are joining the CBCR program further increasing the amount of information exchanged[101].

Action 13 has introduced the exchange of CBC reports between jurisdictions. The report submitted by a UPE or a surrogate entity of an MNE group to the tax authority in its country of residence must be shared with tax authorities in other jurisdictions where constituent entities in the same group either reside for tax purposes or are liable for taxes related to their business activities conducted through a permanent establishment[102].

IV. Critical analysis of the OECD's inclusive framework

[98] Deloitte (2022), "First Penalties for Noncompliance with Transfer Pricing Form Requirements Notified." TaxAtHand, https://www.taxathand.com/article/26995/Belgium/2022/First-penalties-for-noncompliance-with-transfer-pricing-form-requirements-notified, accessed in March 2023.
[99] *Ibidem*.
[100] Fuest, Clemens, et al., (2022), "Corporate Profit Shifting and the Role of Tax Havens: Evidence from German Country-by-Country Reporting Data.", *Journal of Economic Behavior & Organization*, vol. 194, p.455.
[101] OECD (*s.d.*), "Country-specific information on Country-by-Country reporting implementation.", https://www.oecd.org/tax/automatic-exchange/country-specific-information-on-country-by-country-reporting-implementation.htm#cbcrequirements, accessed in March 2023.
[102] OECD (2017b), *Country-by-Country Reporting: Handbook on Effective Implementation*, *op.cit.,* p.23.

A. Profit as the basis of the inclusive framework

The above developments lead us to consider that the OECD has chosen to use profit as the foundation for the application of the framework.

In general, the stated objectives are clear, the IF aims to tax profits where they are generated[103]. Moreover, the implementation of the two pillars is no exception to this principle. Indeed, we have seen that the scope of Pillar One requires a profitability threshold for its application. More fundamentally, Pillar One provides for the possibility of taxation of excess profits, leaving no doubt about it.

We have also seen that the application of Pillar Two was subject to the fact that the company makes profits. Even if its scope does not require any threshold, the notion of profitability does not lose its importance. Indeed, the notion of Net GloBE income is undoubtedly linked to profits, as it represents the amount of money the company has earned after paying all its expenses.

In both situations, it is impossible to apply the requirements of the IF without the company making a profit. In the end, profit becomes the taxable base.

These two tax systems can also be compared following the deductibility of charges and expenses that they allow. In the end, they respectively take the form of a fully tax deductible (a pure profit tax) or fully non-deductible (a turnover tax) system[104].

For decades, economists around the world have argued in favour of tax based on added value (profit tax).

The Diamond and Mirrlees theorem is a perfect example[105]. These famous economists have shown that taxing profits is optimal compared to a turnover taxation because it encourages greater economic efficiency and innovation. In addition, it avoids the economic distortions caused by the latter. Indeed, companies are stimulated to lower their costs and optimise their management. Avoiding disruptions to companies' production decisions is generally the subject of a consortium in economic circles. Indeed, it is common knowledge that it is rarely a good

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[103] OECD (2015a), *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, *op. cit.*

[104] Chen, Xuyang; Hindriks, Jean. Multinational Taxation under Pressure: The Role of Tax Deductibility. LIDAM Discussion Paper CORE ; 2023/13 (2023)

[105] Diamond, Peter A., and James A. Mirrlees. “Optimal Taxation and Public Production I: Production Efficiency.” *The American Economic Review*, vol. 61, no. 1, 1971, *JSTOR*, http://www.jstor.org/stable/1910538. Accessed 6 Aug. 2023.

idea to induce changes in the decisions of companies when they are considered to be rational. In this context, it does not act as a brake on investment for businesses.

Furthermore, taxation on profit avoids cascading taxation down the production chain. It allows only the added value of each link in the chain to be retained, and each player to be taxed only to the extent of his own contribution to the creation of value. In contrast, turnover-based taxation, which covers both costs and revenues, does not allow the value created by intermediaries to be isolated. In this respect, profit-based taxation does not encourage the concentration of activities and allows a better distribution of activities.

Taxation on profits can also be justified by the tax gains resulting from windfall profits. It would result in much higher revenues than those expected under a turnover tax regime[106]. Of course, the situation can be seen the other way round, by considering that if profits are abnormally low, the state is worse off with a system of income tax. Nevertheless, this allows the burden of unforeseen situations to be shared equitably between companies and the state.

From this point of view, taxation on profit makes it possible to maintain a healthy economic structure in which small players, characterised by narrow profitability margins, are not crushed by the burden imposed by taxation on turnover independent of any consideration of profitability. In this context, it enhances tax equity.

However, we must be aware that this consideration may vary depending on the economic and fiscal structure. We have seen that in the digital environment, tax evasion and base erosion call into question all the principles of traditional taxation. This is why we will discover why a profit-based taxation system is far from optimal in this context and its strong international integration.

Introducing a tax system based on corporate profits risks rendering the IF ineffective. As a matter of fact, this means that by artificially inflating their costs, companies can escape the application of the framework despite falling within its scope, at least in terms of turnover

[106] Damonte, Gerardo & Glave, Manuel. (2013). Profit-based versus Production-based Tax Regimes: Latin America's Experience, p. 4.

requirements. It is basically the definition of base erosion: reducing the taxable base to avoid paying taxes.

Fundamentally, to escape the application of the first pillar, the company must ensure that it does not reach the 10% break-even point (the profitability threshold). For this purpose, if it has a turnover of 30 billion dollars, which makes it *a priori* subject to the prescription of this last pillar, the company only has to boost its expenses beyond $27 billion. There are many ways to inflate expenditure. For instance, companies can shift part of their profits to capital expenditure, research and development (hereinafter R&D), expenditure on marketing campaigns and advertising…

There is a plethora of examples of multinationals with huge turnovers that artificially inflate their costs to achieve zero or near-zero profits. We could talk about Starbucks which only paid 5,4 million pounds in corporate taxes while having a turnover approaching 330 million pounds. We could also discuss a Belgian matter and the fact that Engie paid only 61 million euros in taxation while making a turnover of around €1.915 billion in 2021[107].
Engie's tax schemes to avoid taxation on profits led to a case before the Belgian Supreme Court (i.e., Cour de Cassation), which rejected the appeal of the Belgian branch of the French energy company[108]. The appeal concerned a decision of the Brussels Court of Appeal ordering Engie to pay taxes on sums paid to the Dutch subsidiary (Electrabel Nederland Holding bv) which were considered as abnormal or gratuitous benefits. This is an interesting example of cost inflation that does not always pass the national tax authorities' controls.

It is also interesting to pay attention to a tech company that reports zero profit, avoiding being taxed on its profits. For instance, Salesforce.com, a company developing software, managed to pay no taxes in the US in 2020 while being profitable. The craziest thing is that it is estimated that this company faced a negative ETR[109]. It has used a tax break-in for executive

[107] Engie (2022), "Comptes annuels 2021 Electrabel SA : éléments marquants Note de contexte.", p.1. corporate.engie.be/sites/default/files/uploads/CP/one-pager-comptes-ebl-sa-2021-def-fr_1.pdf, accessed in March 2023.
[108] Belgium vs ENGIE CC cv, January 2021, Supreme Court, Case No F.18.0140.N.
[109] Gardner, Matthew and Wamhoff, Steve (2021), "55 Corporations Paid $0 in Federal Taxes on 2020 Profits." Report, Institute on Taxation and Economy Policy, p. 3, https://itep.sfo2.digitaloceanspaces.com/040221-55-Profitable-Corporations-Zero-Corporate-Taxes.pdf, accessed in April 2023.

stock options expenses. This tax benefit enables companies, and therefore Salesforce.com, to deduct expenses associated with stock options for tax purposes[110].

Many countries have introduced R&D incentives in the form of a tax break. It is generally known as a “research tax credit”.

It was developed to encourage companies to invest in R&D and to be able to deduct these expenses[111]. R&D investments are generally likely to have socially desirable effects, but companies need incentives to do so. Unfortunately, these incentives are a perfect example of legal instruments that have been developed to encourage entrepreneurship and business growth through tax relief but are now often misused. Many companies use the term "R&D expenditure" to refer to expenditures that have nothing to do with technological and scientific growth, but which are only intended to inflate deductible expenses.

The IF was designed to tackle BEPS activities, which mostly use gaps in the legal framework to avoid paying taxes. In the context of expense inflation, companies most often use perfectly legal instruments to reduce their reported profits. Therefore, most of the time, it is not enough to simply combat illegal behaviour, in which case repressive measures must be used. Rather, it is a question of how the law is constructed and how the provisions fit together.

One can legitimately ask why the OECD has introduced a profit-based taxation system in its revolutionary project to modernise international taxation. The tax on profits has traditionally been the preferred method of taxation in national legislation. However, the current context of inflating expenditures has led to a shift from this principle to taxation on revenues. The advantages of turnover-based taxation over profit-based taxation are at first sight significant.

Firstly, it is easier to estimate from an administrative point of view. This is because calculating profit requires knowledge of the firm's total sales (revenue) and expenses, which are subject to manipulation and estimation difficulties. Jurisdictions traditionally have easier access to gross revenue data. In the context of international supply chains, estimating costs and benefits for each country individually is no mean feat. Yet this is what is advocated if profits

[110] *Ibidem*, p.4.
[111] Parsons, M. and Phillips, N. (2007), “An Evaluation of the Federal Tax Credit for Scientific Research and Experimental Development”, *Department of Finance Working Paper*, p.1.

are to be taxed where they are generated. As a matter of fact, it is obviously easier to calculate revenues (based on sales for example) than to calculate costs for an individual country.
It also avoids double counting of production costs (especially fixed costs), whether voluntary or not.

It also enables governments to ensure constant and stable revenue collection regardless of the market structure, whether there is perfect competition or a monopoly, and regardless of how profits vary over time. As sales are less volatile than profits, revenue taxation improves the consistency of the amounts levied. This is a good thing for government budgeting.

Moreover, it cancels out the possibility of maximising and manipulating costs. In this way, this does not discriminate between companies. Therefore, it guarantees that all companies, regardless of their capacity to create profits, contribute to the tax effort.

Finally, it does not imply the transmission of sensible information based on production costs and profitability. This lack of confidentiality of industrial information is something we now regret in the IF and the introduction of public CBCR in the EU.

One does not have to look far to find an example of taxation on profits in the digital field. France has shown itself to be a pioneer in this respect by adopting, in 2019, a law creating a tax on digital services, otherwise known as the "GAFA tax law"[112]. The introduction of this law is a response to the legislative slowness of international institutions, such as the OECD and the European Union[113]. France was convinced of the urgent need to fill a legislative gap. Moreover, we will see later that the hopes for quick results from the international talks were dashed by the Trump administration, which was vehemently opposed to such an agreement. These arguments have led the French authorities to go it alone in adopting a legislative framework to address the challenges of taxing digital services, pending a satisfactory solution at a supranational level.

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[112] Loi n° 2019-759 du 24 juillet 2019 portant création d'une taxe sur les services numériques et modification de la trajectoire de baisse de l'impôt sur les sociétés, *Journal Officiel De La République Française,* n°0171, 25 July 2019, art. 1.
[113] Assemblée Nationale Française (2019), "Étude d'impact : Projet de loi portant création d'une taxe sur les services numériques et modification de la trajectoire de baisse de l'impôt sur les sociétés.", p. 7, www.assemblee-nationale.fr/dyn/15/textes/l15b1737_etude-impact, accessed in March 2023.

This law provides for the introduction of a tax on the total annual turnover of MNEs with an overall profit of more than 750 million euros and a French turnover of at least 25 million. The scope of this law is wide and extends from search engine providers to social networks and marketplaces[114]. The tax rate is set at 3% and applies to the services that are linked to France. This law is likely to target some thirty MNEs operating in France and would bring in nearly 650 million euros for the French state in 2022[115].

Obviously, it is well known that this law was adopted before the implementation of the IF. Therefore, it is worth asking whether the implementation of the IF, which requires all jurisdictions to withdraw their unilateral DST[116], does not put an end to the application of the GAFA tax law.

Given that the French law dealt with the taxation of revenues, while it was already clear that the OECD was moving towards a profits-based solution, the scopes of these two texts should not conflict and therefore the French law was designed to resist the application of the future IF developed by the OECD[117]. However, under pressure from the USA, France has agreed to withdraw its DST if international discussions around the IF led to a solution[118]. Therefore, the introduction of the IF signals the end of the GAFA tax law.

Even if the GAFA tax law is a thing of the past, it might be interesting to see what impact it has had on the amounts raised by the French government compared with the situation prior to its introduction. The tax brought in €350 million for France in 2019 and €375 million in 2020[119]. In this respect, it has put an end to situations such as that of Google France, which declared a turnover of just €411 million in 2018 and paid just €17 million in tax, even though its advertising revenues are estimated at €2 billion[120].

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[114] Loi n°2019-759…, *op.cit.,* art.1.
[115] Assemblée Nationale Française (2019), « Étude d'impact… », *op.cit.,* p. 20.
[116] OECD (2023b), *PUBLIC CONSULTATION DOCUMENT Pillar One – Amount A: Draft Multilateral Convention Provisions on Digital Services Taxes and other Relevant Similar Measures,* OECD Publishing, Paris, p. 1.
[117] *Ibidem*, p.18.
[118] Daniel, Justine (2022), "Qu'est-ce que la taxe Gafa ?", Toute l'Europe, www.touteleurope.eu/economie-et-social/qu-est-ce-que-la-taxe-gafa/, accessed in April 2023.
[119] Les Echos, "Impôts : la taxe GAFA a rapporté 375 millions d'euros en 2020.",https://www.lesechos.fr/economie-france/budget-fiscalite/impots-la-taxe-gafa-a-rapporte-375-millions-deuros-en-2020-1342039, accessed June 2023.
[120] Daniel, Justine (2022), *op.cit.*

The intentions of this law were laudable and on the right track in the face of the EU's slow response with a modern legislative tool that is simple to apply. However, the results have been mixed. Between the timid beginnings and the premature repeal of the GAFA law, it must be said that it has not lived up to expectations.
We cannot bury any plans for such a tax, given that this law has not been able to deliver its results, given the time it has been granted. We lack the hindsight and time needed to really assess the impact of such a bill.

The UK has also implemented a turnover-based tax of 2% for search engines and marketplaces as soon as they have a global turnover of more than £500 million and a UK turnover of more than £25 million[121]. During 2018-2019, many European and non-European countries, such as Italia, Spain, and Israel, have announced the introduction of similar bills[122]. In this respect, it is surprising that the OECD has decided to stay with a traditional approach to profit taxation. Clearly, the United States played an important role in shaping the choice of the tax base.

At first glance, it is difficult to understand why a country like the United States of America, which is home to most of the world's largest digital companies, would be interested in signing an agreement to redistribute their profits. The adoption of a legal framework by the United States seems to be the antithesis of a protectionist policy. Indeed, in addition to the fact that companies headquartered in the US would be subject to higher taxes, making them less competitive, the implementation of this IF leads to the leakage of sensitive information, commercial secrets, and tax strategies.
Even if we have seen that the exchange of information, most of the time touching on industrial secrecy, was confidential and confined to national public administrations, the various European projects for the public declaration of data required by the IF are likely to call this confidentiality into question.

Moreover, being naive, it would lead to the leak of profits that could be taxed by the US government to other jurisdictions. It is understandable that a country as powerful in the digital

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[121] Assemblée Nationale Française (2019), « Étude d’impact… », *op.cit.,* p.6.
[122] *Ibidem*, p.6.

domain as the United States adopted such a framework because it saw a clear advantage in doing so and because the impact on its digital businesses was minimal.

Also, the adoption of the framework allows them once again to position themselves as international arbiters and advocates of international cooperation. However, we had to wait for the arrival of the Biden administration before the act could be adopted. His predecessor (i.e., Donald J. Trump) was more protectionist on the subject and undermined further negotiations within the OECD. This is one of the reasons we had to wait until October 2021 to adopt the IF. Even if the USA agreed to adopt the IF, it did so only by retaining profits as the basis for taxation. It is conceivable that the US administration would have been vehemently opposed to revenue-based taxation as discussed above. Such a tax base would make it more difficult to minimise the taxes paid abroad and therefore a significant leakage of tax base from the US to other market jurisdictions. This taxation on profits almost prevents the IF from really developing the effects that could be expected from this international reform.

In practical terms, it is more interesting for a country like the US to sign up to the IF and take a role in the decision-making process than to remain on the side-lines and not be able to change anything.

Another reason we believe the US has adopted the project is that it puts an end to DSTs. The various DSTs set up in certain European countries were considered discriminatory by the USA, given that the companies targeted by them were overwhelmingly American. The French DST bears the stigma of this discrimination, the so-called GAFA tax law (as a reminder, G.A.F.A is an acronym designating the main companies of the digital sector (and all of them are American companies): Google, Apple, Facebook, and Amazon).

It is interesting to note that the US felt attacked by the various DSTs set up by many countries. In response, the US introduced an arsenal of tariffs on European products, leading to a deadweight loss of utility in the global market[123].

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[123] PwC (2021b), "US compromises with the UK, France, Italy, Spain and Austria on digital services taxes and trade actions.", p. 2, https://www.pwc.com/us/en/library/tax-services/articles/2021/pwc-us-compromises-with-the-uk-france-italy-spain-and-austria-on-digital-services-taxes-and-trade-actions.html, accessed in April 2023.

With the introduction of the IF, all DSTs are meant to disappear. It is clearly stated in the IF that unilateral measures constituted by the DSTs should be abolished as soon as the IF takes effect. This results in a waiting period, between the adoption of the framework and its entry into force (an interim period), during which DSTs taken by countries before the adoption of the IF (on 8 October 2021) can continue to be applied[124].

However, the US has agreed with five European countries that had adopted DSTs before the adoption of the IF (Austria, Italy, France, Spain and the UK) to regulate the application of these DSTs during the interim period. The joint statement, the outcome of these discussions, provides that the US will end trade sanctions against these countries (i.e., tariffs). In return, the European countries undertake to reduce amounts owed once Pillar One is in force by excessive amounts collected during the interim period compared to what would have been collected if Pillar One requirements had already been in force[125].

Finally, one might ask whether this explains why the US so "easily" agreed to participate in this project…

B. <u>Dividing points of the inclusive framework:</u>

Although this multilateral agreement has revolutionised the existing international tax rules, it failed to address some important issues. As an example, it did not cover the fate of companies that do not fall within the scope of the two pillars[126]. According to the fact that the turnover required to be covered by both pillars is quite substantial, this makes the number of companies not targeted significant.

Companies that are not subject to the application of both pillars must comply with national rules. That means that these companies can shift their profits and conduct BEPS activities as it was possible before.

Furthermore, because of the high turnover required to fall within the scope of Pillar One and because of the required profitability threshold, we have seen that it is estimated that only 78 of the world's 500 largest companies will be concerned by it[127]. This small number is justified by

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[124] *Ibidem.*

[125] PwC (2021a), "US Compromises on DSTs and Trade Actions." PwC Global, www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-us-compromises-on-dsts-and-trade-actions.pdf, accessed in April 2023.

[126] Spencer, David E. (2022), *op.cit.,* p.24.

[127] Devereux, Michael, and Simmler, Martin (2021), *op.cit.*, p. 1.

the 10% profitability threshold. There are a lot of companies that meet the turnover threshold but that have profitability not exceeding it[128]. Even if the turnover threshold will be reduced in seven years, it does not increase by that much the number of companies that will fall within the scope of the first pillar.

In addition, the application of the IF will only redistribute excess profits to the market jurisdiction. In the end, the world's largest multinational companies will remain taxable in their home jurisdiction. The possibility of artificially inflating profits, which has been seen to render the application of residual profit redistribution sterile, allows the main jurisdictions of establishment not to lose the possibility of taxing profits on MNEs already established within their territory. Finally, the only profound change would be the minimum floor of the tax rate.

Then, the application of Amount A and the taxation right of market jurisdiction raises a problem of tax efficiency. As a matter of fact, companies that are subject to the application of Amount A are taxable on a basis of 25% of the residual profit over 10% because they meet the required thresholds (revenue and profitability). In the meantime, a company that is just below the threshold is not subject to this taxation. This is a very important brake on innovation and enterprise, bearing in mind that it is possible for a company generating a smaller profit of a hundred thousand euros than a similar one to escape the application of the regime subject to the last[129].

The elasticity of demand for digital services is an interesting concept that could be used to see who bears the tax burden. Is it the consumer or the producer (digital companies)? We must be careful that we do not always refer to price-elasticity. Indeed, there are plenty of digital services that are costless for consumers. That does not mean that they are free. In exchange, they collect the data and use them for marketing purposes. As for the traditional economy, the elasticity of demand is specific to each type of service and good. This is why we cannot make a general theory of it. However, for goods and services with inelastic demand, it is finally the consumers who bear the burden of the tax. They support it either by facing higher prices or by being forced to accept a more intensive use of their data. Let us take the example of Netflix or

[128] *Ibidem*, p.3.
[129] Anderson, William T. (2023), "Money Grab: How The G20/OECD Inclusive Framework for Taxation Could Unnecessarily Disrupt Corporate Incentives and Misallocate Taxing Rights", 55 *Vanderbilt Law Review*, p. 1051.

Facebook. Because these services have been present in our lives for a long time, they are less and less perceived as being perfectly substitutable. Therefore, an increase in taxes on digital services could lead in this case to an increase in the burden borne by consumers, who are trapped by their preferences.

Many developing countries, such as African countries, have requested to raise the minimum global tax rate to a minimum of 20%[130]. Evaluating the benefits of the OECD BEPS actions from the perspective of developing countries is no mean feat. On the one hand, with naïveté, one should think that developing countries may want to lower as much as possible to attract the most business. On the other hand, we could say that to collect the maximum amount of money through taxes, developing countries would benefit from having high tax rates.

Because the introduction of the Multilateral Convention (MLC) mandates that all parties remove any DST and comparable measures concerning all companies and commit to refrain from implementing such measures in the future, Kenya has decided, like many other African countries, to keep its DST and therefore not to participate in the IF[131]. The gain was too small according to their calculations. Many countries could also see this obligation as an infringement of their national sovereignty and decide not to join the negotiations.

According to Lee Sheppard, developing countries that have signed the IF of October 8, 2021, will deplore having done so[132]. Indeed, the IF simply removed the possibility for developing states to introduce DSTs in exchange for a promise of a fraction of the excess profits of large companies under pillars one and two. He went on to argue that it was possible to reconcile the application of the IF with that of the DST and that the argument of the risk of double taxation to justify the abolition of the latter was not justified, given that the financial tools now allow us to avoid this risk.
Moreover, the bulk of DSTs rely on turnover-based taxation[133]. This means that by abandoning these national tax instruments, countries joining the IF are also abandoning this tax base in favour of a tax on profits whose drawbacks have already been discussed.

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[130] Spencer, David E. (2022), *op.cit.*
[131] *Ibidem*, p.30.
[132] *Ibidem*, p. 31.
[133] Lucas-Mas, Cristian Óliver, and Raúl Félix Junquera-Varela (2021), *Tax Theory Applied to the Digital Economy: A Proposal for a Digital Data Tax and a Global Internet Tax Agency*. Washington, DC: World Bank. doi:10.1596/978-1-4648-1654-3. License: Creative Commons Attribution CC BY3.0IGO, p. 93.

Furthermore, developing countries do not always have the infrastructure and administration to implement the IF. For it to be effective, we need to have monitoring administrations, dispute resolution procedures... In this respect, it is necessary to promote, once again, international cooperation so that the IF can really be applied in these countries.

Traditionally, there are two main principles of taxation. Taxation at origin and taxation at destination. Taxation at origin, also known as source taxation or residence taxation, is aimed at taxing goods and services where they are produced, while the second principle tends to tax where they are purchased[134]. The traditional legal framework focuses on the origin of value creation in the taxation[135]. As a matter of fact, the international tax system provides a combination of source and residence-based taxation[136].

It is important to note that the digitalisation of the economy has changed the place where value is created. It is no longer created at the origin (i.e., at the place of establishment of the MNE group), but most often at the destination. The consumer or user now takes an active role in the creation of value.

In our view, the IF does not really take the step to modernise the international taxation model by embracing destination-based taxation. Unfortunately, the principle remains that of taxation at origin, where the company is based, with a complementary right to tax excess profits for market jurisdictions (a kind of destination taxation). It can therefore be seen that the latter principle remains on the margins of the IF. We can obviously regret this decision as it neglects the role of the consumer in the creation of value (because his data is used or because he is an integral part of the development of artificial intelligence).

The dematerialisation of activities makes it possible to attribute most of the creation of benefits to the destination, i.e., to the market jurisdiction. In this sense, one may ask why the principle advocated by Pillar One should not be reversed: assign the right to tax profits to the market jurisdiction, within the limit of the profits created in its territory and grant a complementary right to tax profits to the jurisdiction of establishment. In this way, the tax no longer really depends on where the company is located. Destination-based taxation makes profit shifting

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[134] Lockwood, Ben (2001), "Tax competition and tax co-ordination under destination and origin principles: a synthesis", *Journal of Public Economics*, Elsevier, vol. 81(2), p.287.

[135] Devereux, Michael P. and de la Feria, Rita (2014), "Designing and Implementing a Destination-Based Corporate Tax (March 2014)", Oxford University Centre for Business Taxation WP 14/07, p.1.

[136] Auerbach A., Devereux M. and H. Simpson (2008), "Taxing Corporate Income", in J. Mirrlees et al (eds.), *NBER Working Paper No. 14494*, p.46.

impossible[137]. The main advantage of destination-based taxation is to ensure that companies making huge profits in certain countries pay their fair share of taxes.

It introduces another mechanism that risks mitigating its positive effects by generating a loss of income on a global scale. It includes a substance-based carve-out of 5% rate of return on the carrying value of tangible assets and payroll[138]. It is set at 7.5% in the first years of its implementation.

The fact is that with such a mechanism (i.e., a minimum tax rate with exceptions for capital and employment), the OECD does not address the problem of a race to the bottom. In this situation, a company with €1 billion in assets and €50 million in profits in a jurisdiction where the corporate tax rate is 0% would still pay no tax. Worse still, this risks increasing the flight of capital and employment to these jurisdictions[139]. With a 5% carve-out and a minimum tax rate of 15%, it is estimated that tax revenues will be reduced by 15%[140].

Naturally, this issue has been a source of division within the international community, with countries in favour of a strong carve-out and others totally opposed to it, justifying the loss of effect of Pillar 2[141]. Countries arguing for the introduction of a substance-based carve-out are thus advocating the maintenance of tax competition. These countries are generally known as tax havens, where tax revenues represent the vast majority of government revenues.

One final major disadvantage is that some companies could decide not to propose their services in certain countries. Indeed, countries offering low profitability are not attractive for companies that should pay taxes there. If compliance costs are higher than the benefits they could generate, they will not conduct their activities and the citizens of these countries will not benefit from it[142]. As we have just noted, these services can sometimes be less and less substitutable. This will then, if anything, be a real loss for the consumer.

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[137] *Ibidem*, p. 46-48.

[138] Baraké, Mona, Theresa Neef, Paul-Emmanuel Chouc, and Gabriel Zucman (2021), "Minimizing the Minimum Tax? The Critical Effect of Substance Carve-Outs." Post-Print halshs-03323087, HAL, p.3.

[139] *Ibidem.*

[140] *Ibidem, p.4.*

[141] Devereux, Michael P., Simmler, Martin, Vella, John and Wardell-Burrus, Heydon (2021), "What Is the Substance-Based Carve-Out under Pillar 2? And How Will It Affect Tax Competition?," EconPol Policy Brief 39, p. 1.

[142] Anderson, William T. (2023), "Money Grab…", *op. cit.,* p.1059.

These criticisms should not obscure the difficulty of reconciling different, sometimes antagonistic, positions in international negotiations. Each country comes with its interests and the objective is to reach a common solution that meets the expectations of each country as much as possible. Rome was not built in a day.

This IF is a good start in the pursuit of effective and fair taxation of the digital economy, but there is still a long way to go, and it will be necessary to be quick to respond to the constant evolution of the digital economy.

The IF has yet to deliver its full results and effects as its introduction is so recent. No legal instrument is introduced without unexpected effects. The scope and feasibility of legal provisions are only really realised when they are in force. Amendments will be made in response to these unforeseen effects.

C. Future perspectives for the inclusive framework

One of the last meeting of the OECD took place in Paris in early October 2022. The discussions focused on the following main topics: climate change and the global energy crisis, fighting offshore tax evasion and avoidance, capacity building for developing countries and the future of tax administration and digitalisation[143].

The establishment of the Model Rules has already been a major step forward in the introduction by the Contracting States of the requirements of the statement on a two-pillar solution in national legal frameworks[144]. This document was released on 2 February 2023 and its prescriptions are seen as the final building blocks for the implementation of the IF. It was indeed planned to take effect in 2023. As mentioned above, when the IF takes effect, all DSTs set up by the signatory countries will disappear. The first years of the IF's establishment will be decisive for its survival. From our point of view, it is not clear that revenue taxation will be considered in the coming years. The dominant position of the US in negotiations is not likely to change and the risk of trade sanctions in the form of increased tariffs on imported products is likely to discourage other countries from engaging in discussions on this issue.

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[143]OECD (2022f), *14th meeting of the OECD/G20 Inclusive Framework on BEPS*, https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-meeting-october2022.htm#:~:text= About,OECD%20Conference%20Centre%20in%20Paris, accessed in April 2023.

[144] OECD (2023c), *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), op.cit.*

On 11 July 2023, the contracting members of the inclusive framework met to discuss the continuation of the project. They reached an agreement to pursue the implementation of the legislative act[145].

V. Conclusion

This paper was an opportunity for us to revisit century-old principles of international taxation. We have come to understand that these principles are no longer adapted to the challenges of the new digital economy.

In this regard, the purpose of this contribution was to consider the OECD inclusive framework on the challenges raised by taxation in the digital economy. From both a descriptive and a critical perspective, we have detailed the salient features of the application of this framework.

We have seen that the IF was a revolution and has profoundly transformed international taxation.

The appeal and need for taxation of the digital economy is not likely to fade in the coming years, quite the contrary. In the same way, we have seen that national responses were not sufficient to tackle issues raised by the digitalisation of the economy.

However, international responses are not much more helpful in addressing these. In this respect, we have seen that the IF is ill-equipped. We have also been able to attribute a large part of this responsibility to the choice of profits as the tax base.

We are still waiting for a real assessment of the implementation of the framework. It will then be time to make changes if necessary.

This should not make us forget that other challenges are still pending. We are thinking, for example, of the processing of user data and the respect of privacy, into which the economy is increasingly intruding.

[145] OECD (2023d), *Outcome Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

Despite the many criticisms we have had, this contribution has helped us to understand that international cooperation is essential and that these initiatives should be encouraged. Particular attention should however be paid to considering the fragility of developing countries regarding the taxation of multinationals.

Finally, we look forward to seeing what the inclusive framework holds and how it will evolve throughout the various OECD summits. We will also see if this framework resists the current pressures generated by the tensions between the West and the East. The various economic sanctions imposed on different Eastern countries undermine the balance achieved by the IF.

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UNIVERSITÉ CATHOLIQUE DE LOUVAIN
Faculté des sciences économiques, sociales, politiques et de communication
Place Montesquieu, 4 bte L2.05.01, 1348 Louvain-la-Neuve, Belgique | **www.uclouvain.be/espo**