The debate on digital taxes and its relevance for Luxembourg

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Cette contribution vise à faire l'état de la discussion autour de l'imposition des sociétés offrant des services numériques. Les développements au niveau de l'OCDE, notamment dans le contexte du plan d'action BEPS et le premier point d'action sur l'imposition de l'économie numérique, seront brièvement expliqués. Les positions de l'Union européenne et des Nations unies sont également détaillées. Par ailleurs, les conséquences d'une adoption potentielle des mesures proposées pour le Luxembourg seront détaillées.

This article summarizes the current discussions about "taxing the digital", as being mainly led by the OECD in the framework of its BEPS Action 1. The positions of the European Union and the United Nations are explained as well. Furthermore, the effects of the potential adoption of the proposed measures for Luxembourg will be explained.

Introduction

Roughly ten years ago, the international community of States decided to attack the issue of potential tax concerns of the economy's digitalization more concretely by including a first action point on the "tax challenges of the digital economy" in the Base Erosion and Profit Shifting ("BEPS") Action Plan brought into being by the Organization for Economic Co-operation and Development ("OECD").[1] In the meantime, the limited circle of OECD member countries has been joined by developing countries via the so-called "Inclusive Framework" and led discussions to a global perspective involving now 141 States.[2] The fact that many countries participate underlines the global importance and outreach of the discussions, and appears to be unique in the history of taxation when it comes to negotiating as fundamental international tax principles as is currently done.

The concrete issue at stake concerns the taxation of business profits that is, under current international tax rules as reflected in double tax conventions ("DTCs"), reserved to the business' residence State unless a permanent establishment of the business exists in another State.[3] In the latter case, the State of the permanent

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1 OECD, "Action Plan on Base Erosion and Profit Shifting", 2013, published online: https://www.oecd.org/ctp/BEPSActionPlan.pdf (last access: 15 January 2022), p. 10.

2 The Inclusive Framework has been initiated in 2016. OECD, "What is BEPS?", 2022, published online: https://www.oecd.org/tax/beps/about/ (last access: 15 January 2022), section "How it works".

3 Art. 7 (1) of the OECD Model Tax Convention on Income and on Capital, 2017 ("OECD MC").

establishment, which is a “fixed place of business through which the business of an enterprise is wholly or partly carried on” according to article 5 (1) of the OECD MC, may tax the part of business profits attributable to that permanent establishment.[4] Whereas the residence State of an enterprise can be chosen quite arbitrarily by the enterprise, the permanent establishment definition has been thought of as re-establishing the tax balance towards States where businesses effectively carry on their activity so that these States should also be able to tax profits that are generated within their territory. With the digitalization of the economy, a “fixed place of business”, however, is no longer required to carry on significant business activity. Therefore, the balancing between residence and permanent establishment States is impacted, as the factual activity of a business is no longer linked to the physical presence of the business in a particular State.

Several options can be envisaged to address this issue: either the existing DTC rules are modified to move away from the requirement of physical presence in form of a permanent establishment, or additional levies are imposed that apply outside of the ordinary corporate business tax framework and do not conflict with the provisions of DTCs as they currently stand. In case of the first option, again, different tax mechanisms could be adopted that might even move away from “traditional” business profit taxation (i.e., net profit taxation based on a tax return filed by the taxpayer concerned).

Whereas some of the actions of the OECD BEPS Action Plan already led to concrete results having been implemented through the “Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS” (“MLI”) in November 2016,[5] Action 1 on “Tax Challenges Arising from Digitalisation” yet remains subject to negotiations that seem, however, to be about reaching their final stage.[6] The topic being highly political, the European Union (“EU”) reacted as well: whereas own directive proposals on both a short-term and long-term solution have been initiated in 2018,[7] the Member States agreed in the meantime to refrain from acting on an “EU-only” level and rather bundled efforts to find a common position in the OECD negotiations.[8] As a backstop, the Member States reserve the right to push for an EU digital levy should the global OECD negotiations do not result in the adoption of a tax.

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[4] *Ibid.*

[5] OECD, “Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting”, published online: https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf (last access: 15 January 2022).

[6] For information on BEPS Action 1, please refer to: OECD, “Action 1: Tax Challenges Arising from Digitalisation”, published online: https://www.oecd.org/tax/beps/beps-actions/action1/ (last access: 15 January 2022).

[7] The long-term solution is entitled “significant digital presence”, *see* European Commission, Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, 21 March 2018, COM(2018) 147 final, published online: https://data.consilium.europa.eu/doc/document/ST-7419-2018-INIT/en/pdf (last access: 15 January 2022). The so-called “digital services tax” has been thought of as short-term solution, *see* European Commission, Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, 21 March 2018, COM(2018) 148 final, published online: https://data.consilium.europa.eu/doc/document/ST-7420-2018-INIT/en/pdf (last access: 15 January 2022).

[8] Statement of the Members of the European Council, 25 March 2021, SN 18/21, published online: https://www.consilium.europa.eu/media/48976/250321-vtc-euco-statement-en.pdf (last access: 15 January 2022), para. 6 (g).

Furthermore, the United Nations have adopted a new model tax treaty provision that is article 12B on income from automated digital services.[9] This provision allows both the residence and the source State to tax covered income and operates within the known framework of international business taxation.

This contribution outlines the developments at the level of the OECD in section I. It continues by explaining the EU initiatives in section II. and the proposed new model tax provision on income from automated digital services in the United Nations Model Tax Convention ("UN MC") in section III. In its conclusive section IV., the significance of these developments for Luxembourg is explained.

I. The OECD/Inclusive Framework negotiations – BEPS Action 1

The global political discussions about adapting the international tax rules on business profit taxation to the digitalized functioning of today's economy is reflected in several publications, which are briefly explained in below sub-sections.

A. The 2015 "final" report

In 2015, the OECD published an extensive report on the challenges of the digital economy that describes different business models in the digital economy and their essential characteristics.[10] Concretely, the OECD sums up the challenges for taxation as regards taxable nexus, data and income qualification ("characterisation").[11] According to the OECD, the central question in this first BEPS action is to divide taxing rights between States regarding profits that are generated by digitalised businesses.[12] Potential tax solutions to be envisaged are described, as for example the adaptation of the permanent establishment concept as to include a "significant economic presence", a withholding tax or equalisation levies.[13] No conclusion could, however, be found at that stage on how the challenges are best addressed and which tax mechanism should be retained or further developed.[14]

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[9] Committee of Experts on International Cooperation in Tax Matters, "Tax consequences of the digitalized economy – issues of relevance for developing countries", 6 April 2021, published online : https://us.eversheds-sutherland.com/portalresource/CITCM1.pdf (last access: 15 January 2022).
[10] OECD, "Addressing the Tax Challenges of the Digital Economy – Action 1: 2015 Final Report", 5 October 2015, published online: https://dx.doi.org/10.1787/9789264241046-en (last access: 15 January 2022), chapter 4.
[11] *Ibid.*, paras. 248 ff.
[12] *Ibid.*, paras. 246 ff. and 340.
[13] *Ibid.*, paras. 277 ff.
[14] *Ibid.*, paras. 357 ff.

B. The 2018 interim report

In 2018, another report has been published by the OECD that aimed at stating the progress made so far in the negotiations around "taxing the digital". The report further details the functioning of digitalised business models and their value creation processes. Three main elements have been worked out regarding the functions of digitalised business models: cross-jurisdictional scale without mass (meaning that businesses can operate at large scale in territories without being physically present there), increasing reliance on intangibles including intellectual property and increasing reliance on data, user participation and resulting synergies with intellectual property.[15] The negotiating States were, however, inconclusive on whether and how much these characteristics contribute to the value creation of digitalised business models and whether this diverges from non-digitalised business models.[16]

Moreover, this report gives an extensive overview on digital tax measures already adopted by States.[17] For instance, the concept of "significant economic presence" has already been implemented by Israel in 2016 and the Slovak Republic in 2017.[18] India, Italy, Hungary, and France already introduced gross basis taxes on certain activities only.[19] Beyond that, anti-abuse rules, like the Australian and British "diverted profits tax" and the US American "Base Erosion and Anti-Abuse Tax" ("BEAT") are explained in the OECD report.[20]

The report also outlined the divergence in opinions on whether – at all – the digitalized economy should be subject to new tax rules, respectively whether existing rules should be adapted as to better reflect the economic reality brought by digitalisation. Three groups of opinion could be formed. The first one favours only small adjustments of the existing tax system distinguishing between residence and source States.[21] An adaptation of the permanent establishment concept is suggested, but the provision of the market alone is not considered to be sufficient to justify taxing rights for the market State.[22] A second group of States, of which Luxembourg is part, opines that the results of the BEPS project are satisfying and rejects further modifications of tax treaties to digitalised business activities.[23]

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15 OECD, "Tax Challenges Arising from Digitalisation – Interim Report 2018", 16 March 2018, published online: https://www.oecd.org/ctp/tax-challenges-arising-from-digitalisation-interim-report-9789264293083-en.htm (last access: 15 January 2022), paras. 33 ff.

16 *Ibid.*, para. 36. *See also*: W. Schön, "Ten Questions about Why and How to Tax the Digitalized Economy", *Bulletin for International Taxation*, 2018, p. 280; M. Olbert and C. Spengel, "International Taxation in the Digital Economy: Challenge Accepted?", *World Tax Journal*, 2017, p. 9 f.; J. Hey, "'Taxation Where Value is Created' and the OECD/G20 Base Erosion and Profit Shifting Initiative", *Bulletin for International Taxation*, 2018, pp. 203-204; E. Kemmeren, "Should the Taxation of the Digital Economy Really Be Different?", *EC Tax Review*, 2018, p. 73; F. van Horzen and A. van Esdonk, "Proposed 3 % Digital Services Tax", *International Transfer Pricing Journal*, 2018, section 4.1., published online at www.ibfd.org; A. P. Dourado, "Digital Taxation Opens the Pandora Box", *Intertax*, 2018, pp. 568 and 571 f.; M. Devereux and J. Vella, "Implications of Digitalization for International Corporate Tax Reform", *Intertax*, 2018, p. 555 f.

17 OECD, "Tax Challenges Arising from Digitalisation – Interim Report 2018", 16 March 2018, *op. cit.*, chapter 4.

18 *Ibid.*, para. 351.

19 *Ibid.*, para. 359.

20 *Ibid.*, para. 363.

21 *Ibid.*, para. 389.

22 *Ibid.*, paras. 389-390.

23 *Ibid.*, para. 394.

A third group is formed in the majority by less developed economies and agrees that a fundamental reform of the existing international tax system is necessary, which they consider to be flawed from the outset and not only impacted by digitalisation.[24] These States reject specific provisions for digitalised business activities but demand for more substantive changes covering all sorts of businesses.[25]

In 2018, the report states the thereafter much discussed requirement to make big tech companies pay their "fair share" of tax in States where they offer their services.[26] Nevertheless, the OECD negotiations could not lead to the conclusion of recommending any tax measure at that stage, leave alone to consensus on the adoption of any measure in all participating States.[27]

C. The 2019 policy note, public consultations, and programme of work

In the year 2019, the two-pillar approach that is retained and further developed until today has been mentioned for the first time. The approach has first been mentioned in a "policy note"[28] and led to a first public consultation, in which more than 200 representatives of all the private sector, academia and civil society participated.[29]

The two pillars distinguish between the adaptation of nexus and profit attribution rules (pillar one) and minimum tax rules called "global anti-base erosion proposal" ("GloBE", pillar two) in the 2019 documents.[30] The second pillar does not deal with the taxation of digitalised businesses specifically, but more generally with the introduction of global anti-abuse rules.

Regarding the first pillar, the OECD proposes the distinction of three different approaches in the first half of the year 2019: a "user participation", a "marketing intangibles" and a "significant economic presence" approach. The aim of all approaches is to revise nexus rules as to allocate taxing rights to the market State

24 *Ibid.*, para. 391.
25 *Ibid.*, para. 392.
26 *Ibid.*, paras. 396 and 408. *See also* European Commission, Communication from the Commission to the European Parliament and the Council, *A Fair and Efficient Tax System in the European Union for the Digital Single Market*, 21 September 2017, COM(2017) 547 final, published online: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017DC0547&from=DE (last access 15 January 2022), p. 8.
27 OECD, "Tax Challenges Arising from Digitalisation – Interim Report 2018", 16 March 2018, *op. cit.*, para. 404.
28 OECD, "Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note", 23 January 2019, published online: http://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf (last access: 15 January 2022).
29 OECD, "OECD invites public input on the possible solutions to the tax challenges of digitalization", 19 February 2019, published online: http://www.oecd.org/tax/beps/oecd-invites-public-input-on-the-possible-solutions-to-the-tax-challenges-of-digitalisation.htm (last access: 15 January 2022); OECD, "Public Consultation Document: Addressing the Tax Challenges of the Digitalisation of the Economy – 13 February – 6 March 2019", 13 February 2019, published online: http://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf (last access: 15 January 2022).
30 *See, e.g.,* OECD, "Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy", 31 May 2019, published online: https://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf (last access: 15 January 2022).

without the business necessarily being physically present in that market State.[31] The "user participation" approach would only apply to certain highly digitalised entities, such as social media networks, online search engines and online marketplaces, based on the assumption that users contribute essentially to the value creation of these business models.[32] The "marketing intangibles" approach would apply to all sorts of digitalised businesses and "addresses a situation where a [multinational enterprise] group can essentially reach into' a jurisdiction, either remotely or through a limited local presence [...], to develop a user/customer base and other marketing intangibles".[33] The "significant economic presence" approach would grant taxing rights to jurisdictions where a number of factors are fulfilled that prove "a purposeful and sustained interaction with the jurisdiction via digital technology and other automated means".[34] Factors could include, for instance, the existence of a user base or the maintenance of a local website.[35] Profit allocation discussed under pillar one in 2019 is based on three options: either a modified residual profit split method could be applied, or a fractional apportionment method, or distribution-based approaches.[36]

The second pillar envisages the introduction of a global minimum tax, to be implemented both in national tax systems and double tax treaties. The GloBE proposal should contain two inter-related rules, namely an income inclusion rule and a tax on base eroding payments.[37] The income inclusion rule "would tax the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate" and the tax on base eroding payments "would operate by way of a denial of a deduction or imposition of source-based taxation (including withholding tax), together with any necessary changes to double tax treaties, for certain payments unless that payment was subject to tax at or above a minimum rate".[38] The tax on base eroding payments would again contain two elements: an undertaxed payments rule (denying deductions or imposing source-based taxation for payments to related parties if these payments were not subject to tax at a minimum rate) and a subject to tax rule (granting certain treaty benefits only if the income was subject to tax at a minimum rate).[39]

In the second half of the year 2019, a second publication consultation procedure was launched in October/November that required input on a "unified approach" already mentioned in the earlier documents and worked out in more detail by the

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[31] *Ibid.*, para. 23 ; OECD, "Public Consultation Document: Addressing the Tax Challenges of the Digitalisation of the Economy – 13 February – 6 March 2019", 13 February 2019, *op. cit.*, para. 58.
[32] *Ibid.*, paras. 18-19.
[33] *Ibid.*, para. 30.
[34] *Ibid.*, para. 51.
[35] *Ibid.*
[36] OECD, "Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy", 31 May 2019, *op. cit.*, paras. 28 ff.
[37] *Ibid.*, para. 56.
[38] *Ibid. See also* M. Wünnemann, "Herausforderungen der Besteuerung der digitalen Wirtschaft im Jahr 2019", *Internationales Steuerrecht*, 2019, pp. 134 ff.
[39] OECD, "Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy", 31 May 2019, *op. cit.*, para. 73.

OECD in the meantime.[40] The unified approach presents an evolution of the three different approaches presented earlier under pillar one in order to reach global consensus, which could not be achieved with the three divergent approaches.[41] The negotiating States agreed at that point, however, that the unified approach should provide for taxation in the market jurisdiction, even where businesses are not physically present there; going beyond the arm's length standard and departing from the separate entity principle traditionally retained for the taxation of permanent establishments; and that the approach should "search for simplicity, stabilisation of the tax system, and increased tax certainty in implementation".[42] Based on these preliminary findings, a measure is suggested that applies to digitalised, but also other large consumer-facing businesses.[43] Exemptions for certain business activities are envisaged.[44] The new nexus rule should be based on revenues generated in the market jurisdiction and should implement country-specific thresholds for better practicability and inclusion of smaller economies at the same time.[45] The arm's length standard should be maintained but completed by formula-based mechanisms.[46] Tax certainty shall be ensured by dividing the new taxing right into three tiers, entitled "amounts A, B and C". Amount A should constitute a "share of deemed residual profit allocated to market jurisdictions using a formulaic approach", amount B should provide "a fixed remuneration for baseline marketing and distribution functions that take place in the market jurisdiction" and amount C should provide "binding and effective dispute prevention and resolution mechanisms relating to all elements of the proposal, including any additional profit where in-country functions exceed the baseline activity compensated under Amount B".[47] The OECD furthermore suggests to introduce the new taxing right as a standalone rule rather than as a modification to existing rules, i.e., articles 7 and 5 of the OECD MC.[48]

D. The 2020 statements and blueprint reports

In 2020, the OECD published a statement further specifying the two-pillar approach and containing a new programme of work.[49] The statement confirms the approach in pillar one to introduce a new taxing right not only for highly digitalised, but also other consumer-facing businesses. It explains the broadening

[40] OECD, "Public Consultation Document: Secretariat Proposal for a "Unified Approach" under Pillar One – 9 October – 12 November 2019", 9 October 2019, published online: https://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf (last access: 15 January 2022).
[41] *Ibid.*, para. 7.
[42] *Ibid.*, para. 10.
[43] *Ibid.*, para. 20.
[44] *Ibid.*
[45] *Ibid.*, para. 15.
[46] *Ibid.*, para. 18.
[47] *Ibid.*, para. 15.
[48] *Ibid.*, para. 22.
[49] OECD, "Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy", 31 January 2020, published online: https://www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps.htm (last access: 15 January 2022). The programme of work is contained in Annex A.

of the scope with the fact that not only highly digitalised, but also other consumer-facing businesses, do no longer need to be physically close to their customers in order to provide their services.[50]

Within pillar one, two categories of businesses shall be concerned: automated digital services and consumer-facing businesses. The first category would include, for instance, online search engines, social media networks, online intermediary services such as marketplaces, streaming services, cloud computing services and online advertising services. These services have in common that they can be offered in a standardised manner to many customers and users in different countries.[51] The second category would concern businesses offering goods and services that are typically sold to end customers for personal use purposes, such as clothing, cosmetics, luxury goods or cars.[52] The Statement maintains the idea to provide a carve-out for certain businesses, such as the natural resources or financial industries.[53] Moreover, the Statement plans to introduce a worldwide and country-specific revenue threshold to delimit the scope of the new taxing right that should apply only to large multinational enterprises.[54] The Statement also maintains the distinction between amounts A, B and C, where amount A constitutes the new taxing right in market jurisdictions; amount B a fixed remuneration for baseline distribution and marketing functions and amount C "any additional profit where in-country functions exceed the baseline activity compensated under Amount B".[55] The OECD emphasises already that the exact delineation between amounts B and C is not yet clarified and subject to further negotiations.[56]

Two blueprint reports on the two different pillars are published in October 2020.[57] The blueprint report on pillar one manifests the new taxing right entitled "amount A" introduced to allow market jurisdictions to tax residual profits of digitalised but also other consumer-facing businesses.[58] To determine the scope of application, the blueprint report provides for an activity test: for automated digital services, a list of covered and exempt services is provided. First, taxpayers would need to check whether either of the lists apply to their business activity. Should they not find their activity on either list, a general definition must be

[50] *Ibid.*, paras. 18-20; OECD, "Public Consultation Document: Secretariat Proposal for a 'Unified Approach' under Pillar One – 9 October – 12 November 2019", 9 October 2019, *op. cit.*, paras. 22-23.
[51] OECD, "Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy", 31 January 2020, *op. cit.*, para. 22.
[52] *Ibid.*, paras. 24-28.
[53] *Ibid.*, paras. 30-32.
[54] *Ibid.*, para. 35.
[55] *Ibid.*, para. 10.
[56] *Ibid.*, paras. 76 ff.
[57] OECD, "Tax Challenges Arising from Digitalisation – Report on the Pillar One Blueprint", 14 October 2020, published online: https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-one-blueprint-beba0634-en.htm (last access: 15 January 2022); OECD, "Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint", 14 October 2020, published online: https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-two-blueprint-abb4c3d1-en.htm (last access: 15 January 2022).
[58] OECD, "Tax Challenges Arising from Digitalisation – Report on the Pillar One Blueprint", 14 October 2020, paras. 21 ff.

consulted that is constructed on two elements: "automated" and "digital".[59] Consumer-facing businesses would include "businesses that generate revenue from the sale of goods and services of a type commonly sold to consumers, i.e. individuals that are purchasing items for personal use and not for commercial or professional purposes".[60] Beyond the activity test, threshold tests are thought to apply: only businesses that have global gross revenues of at least 750 million EUR shall be subject to the new taxing right; and a country-specific revenue threshold should apply as well, but is not yet determined in this document.[61] The blueprint report discusses whether a permanence test should apply beyond these requirements.[62]

The blueprint report on pillar one does not yet define how much residual profit should be allocated to the market State and it neither defines how exactly customers and users shall be localised in order to find them being located in a market State.[63] The OECD suggests implementing a "revenue sourcing principle" for each business model covered, which in turn shall be accompanied by specific, hierarchised "indicators".[64] The blueprint report further details that next to amount A, amount B on a fixed remuneration for distribution and marketing functions shall be determined, but no amount C will any longer exist. Amount B shall be calculated based on the arm's length standard and shall facilitate the application of this standard for covered activities to the benefit of less developed economies.[65]

The blueprint report on pillar two provides for the global anti-abuse rule and aims at implementing as a principal mechanism an income inclusion rule, combined with an undertaxed payments rule as a backstop.[66] The income inclusion rule provides for taxation in the residence State, where the source State does not tax sufficiently, and is based on traditional "controlled foreign company" rules.[67] In cases of application of the income inclusion rule, a switch-over rule shall apply to prevent the application of the exemption method provided for by article 23A of the OECD MC in these cases.

The backstop "undertaxed payments rule" applies only where the income inclusion rule does not apply and denies deduction for intra-group payments where these payments are not sufficiently taxed in the source jurisdiction.[68] A "subject to tax rule" applies in addition to these rules, denying tax treaty benefits for payments

[59] *Ibid.*, para. 26: "Automated" means that "once the system is set up the provision of the service to a particular user requires minimum human involvement on the part of the service provider" and "digital" means that the service is "provided over the Internet or an electronic network."
[60] *Ibid.*, para. 52.
[61] *Ibid.*, paras. 175 ff.
[62] *Ibid.*, para. 196.
[63] *Ibid.*, paras. 8, 496 ff, 218 ff.
[64] *Ibid.*, paras. 226 ff.
[65] *Ibid.*, paras. 649 ff. *See also* F. Thörmer, "Das neue Besteuerungsrecht der Marktstaaten an digitalen und konsumentenorientierten Geschäftsmodellen – Eine stabile Säule der neuen 'Weltordnung'?", *Betriebs-Berater*, 2021, pp. 603 ff.
[66] OECD, "Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint", 14 October 2020, para. 9.
[67] *Ibid.*
[68] *Ibid.*, paras. 457 ff.

not sufficiently taxed in the other contracting State.[69] Pillar two shall only apply to large enterprises with a consolidated annual revenue of at least 750 million EUR.[70]

The developments in 2020 are terminated with a third public consultation procedure, launched from October to December 2020.[71] A discussion of the again more than 200 replies to the procedure took place on 14 and 15 January 2021.[72]

E. The 2021 statements

The OECD published two statements in 2021 that further specify the progresses made so far in finding a consensus solution for both pillars.[73] In 2021, regarding pillar one, the negotiating States agree that no distinction of any businesses falling in the scope of the new taxing rights shall be operated, but merely that amount A shall cover multinational enterprises that generate worldwide annual revenues of at least 20 billion EUR and that have a profitability rate of at least 10 %.[74] In case of successful implementation of amount A, the threshold shall be reduced to 10 billion EUR.[75]

The reason for the broadening of scope and the preference of high revenue thresholds over activity tests may be explained by the compromise that needed to be found with the United States of America that have rejected the idea of introducing specific taxes for digitalised entities and threatened starting a trade war.[76]

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[69] *Ibid.*, paras. 566 ff.
[70] *Ibid.*, para. 113. For a critical discussion, *see* X. Ditz and R. Pinkernell, “Die neue “Weltsteuerordnung” rückt näher: OECD veröffentlicht Blueprints zu den Säulen 1 und 2”, *Internationale Steuer-Rundschau*, 2020, pp. 417 ff.
[71] OECD, “Tax and digital: OECD/G20 Inclusive Framework on BEPS invites public input on the Pillar One and Pillar Two Blueprints”, 12 October 2020, published online: https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-invites-public-input-on-the-reports-on-pillar-one-and-pillar-two-blueprints.htm (last access: 15 January 2022).
[72] OECD, “Tax and digital: Public consultation meeting on the Pillar One and Pillar Two Blueprints”, 14-15 Januar 2021, video and meeting documents published online: https://www.oecd.org/tax/beps/public-consultation-meeting-reports-on-the-pillar-one-and-pillar-two-blueprints.htm (last access: 15 January 2022).
[73] OECD, “Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy”, 8 October 2021, published online: https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf; accompanied by a FAQ document (published online: https://www.oecd.org/tax/beps/faqs-statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf) and a highlights brochure (published online: https://www.oecd.org/tax/beps/brochure-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf); OECD, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy, 1 July 2021, published online: https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf; also accompanied by a highlights brochure“ (published online: https://www.oecd.org/tax/beps/brochure-addressing-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf) (last access: 15 January 2022).
[74] OECD, “Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy”, 8 October 2021, *op. cit.*, p. 1; OECD, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy, 1 July 2021, *op. cit.*, p. 1.
[75] *Ibid.*
[76] Handelsblatt, “USA einigen sich mit fünf Ländern auf Steuerkompromiss – und wenden so einen Zollkrieg ab”, 21 October 2021, published online: https://www.handelsblatt.com/politik/international/digitalsteuer-usa-einigen-sich-mit-fuenf-laendern-auf-steuerkompromiss-und-wenden-so-einen-zollkrieg-ab/27728108.html?ticket=ST-4961336-wtodCMnaaBOVBVrdMb1h-cas01.example.org (last access: 15 January 2022); Ditz/Pinkernell, *op. cit.*, p. 450.

Merely extractives and regulated financial services remain excluded from the scope of application of amount A.

Right now, amount A provides for taxation of business profits in market States where the taxpayer "derives at least 1 million euros in revenue from that jurisdiction" (250,000 euros for jurisdictions with a GDP below 40 billion euros).[77] The October Statement states that "25 % of residual profit defined as profit in excess of 10 % of revenue will be allocated to market jurisdictions using a revenue-based allocation key".[78] A country is considered to be the market jurisdiction "where goods or services are used or consumed" in that State.[79] The OECD will develop "detailed source rules for specific categories of transactions".[80] Amount B is furthermore retained and shall provide for a simplification of the arm's length standard for cases covered, to make less developed economies with lower capacities benefit from this rule.[81]

A milestone of the 2021 developments is the moratorium of unilateral measures such as digital services taxes that the negotiating States agreed on in October.[82] A multilateral convention shall require the abolition of such measures and shall be developed and opened for signature in 2022, bringing the application of amount A into effect as early as 2023.[83] The timeframe seems to be more than ambitious, considering the length of negotiations taken so far.

Regarding the second pillar, the roughly 140 negotiating States agree substantively on what has been elaborated on earlier. Moreover, they state that the GloBE rules will have the "status of a common approach", not binding the members of the Inclusive Framework to adopt these rules, but if they do, they are required to apply the rules consistently with what is agreed on commonly.[84] The minimum tax rate for the income inclusion rule and the undertaxed payments rule is fixed at 15 %.[85]

II. Digital taxes and the European Union

In the early phase of negotiating the adaptation of tax rules to the digitalized economy, there has been a certain co-existence between the negotiations at the level of the OECD and those at the level of the EU. As progress has not been significant in the OECD negotiations, the EU Member States decided to accelerate the

[77] OECD, "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy", 8 October 2021, *op. cit.*, p. 1.
[78] *Ibid.*, p. 2.
[79] *Ibid.*
[80] *Ibid.*
[81] *Ibid.*, p. 3.
[82] *Ibid.*
[83] *Ibid.*
[84] *Ibid.*
[85] *Ibid.*, p. 4.

discussions and put political pressure on the international community of States by proposing two directives on both a long- and a short-term solution. Following these proposals and their revisions that however ultimately did not lead to the adoption of any directive, Member States agreed to limit EU-only actions to the benefit of a common, global tax solution to be found at the level of the OECD. However, the potential adoption of EU-only legislative acts remained an important means to put political pressure on the OECD negotiations.

A. The 2018 directive proposals

The proposal for a short-term solution envisaged the adoption of a digital services tax[86] that provided a model tax mechanism later serving as a basis for national implementations of such tax.[87] The digital services tax should operate outside of the corporate tax framework and thereby allow an application without changing tax treaties. The tax applies to turnover and is levied at a rate of 3 %.[88] It only applies to entities generating gross annual revenues exceeding 750 million EUR and covered gross annual revenues within the EU of at least 50 million EUR.[89] The taxable basis is formed by gross revenues stemming from certain covered services: "the placing on a digital interface of advertising targeted at users of that interface; the making available to users of a multi-sided digital interface which allows users to find other users and to interact with them, and which may also facilitate the provision of underlying supplies of goods or services directly between users; [and] the transmission of data collected about users and generated from users' activities on digital interfaces".[90] To localise these activities, the European Commission suggests the place of location of users, which may be determined in different ways according to the service concerned.[91] The user's place of location should coincide with the place of the user's device used to access the service. This device in turn shall be located by virtue of the Internet Protocol ("IP") address of such device or "any other method of geolocation".[92]

The long-term solution of the European Commission as envisaged in 2018 consists of the adaptation of the permanent establishment concept so as to include "significant digital presence".[93] It should apply to all corporate taxpayers irrespective of their residence[94] that provide digital services. Digital services are defined as services "delivered over the internet or an electronic network and the nature of

[86] European Commission, Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, 21 March 2018, COM(2018) 148 final, *op. cit.*
[87] *E.g.* in Austria or France.
[88] European Commission, Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, 21 March 2018, COM(2018) 148 final, *op. cit.*, art. 8.
[89] *Ibid.*, art. 4 (1).
[90] *Ibid.*, art. 3 (1).
[91] *Ibid.*, art. 5 (2).
[92] *Ibid.*, art. 5 (5).
[93] European Commission, Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, 21 March 2018, COM(2018) 147 final, *op. cit.*
[94] *Ibid.*, art. 2.

which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology".[95] Non-resident taxpayers of States that have concluded a DTC with the Member State concerned shall, however, only be subject to the rule, if the DTC contains a similar rule to that of the directive. The significant digital presence is determined to exist in a Member State "if the business carried on through it consists wholly or partly of the supply of digital services through a digital interface", but only if one out of three conditions is fulfilled: the total revenues obtained from the supply of those digital services exceed 7 million EUR per tax year; the business has at least 100,000 users using these digital services; or the business has concluded more than 3,000 business contracts for the supply of the digital services with users.[96] As the user is again crucial to this concept, the directive proposal is similar to the proposal for a digital services tax in finding a person to be considered as user where the user's device can be located within the territory of a Member State either by virtue of its IP address or any other means of geolocation.[97] Profit attribution rules under the directive proposal follow already existing profit attribution rules with a few specifications given in the proposal.[98]

B. Reactions on the OECD/Inclusive Framework global negotiations

Member States decided first to focus on the proposal for a digital services tax, that became in the course of 2018 a "digital advertising tax" that, however, has been rejected in March 2019.[99] Member States agreed to focus on a more long-term, global solution. To increase political pressure, the Commission has been invited to propose the adoption of a digital levy in July 2020.[100] This has been again emphasised in November 2020, where the Council expresses that "the Commission, as a basis for additional own resources, will put forward in the first semester of 2021 a proposal for a digital levy, with a view to its introduction at the latest by 1 January 2023".[101] The Council, nevertheless, invited the Commission to take into account the developments at the OECD level.

In 2021, the Member States reiterated their commitment to reaching a global consensus solution on the level of the OECD and its Inclusive Framework, but

95 *Ibid.*, art. 3 (5). A tentative list is provided in this provision and the annexes of the directive proposal.
96 *Ibid.*, art. 4 (3).
97 *Ibid.*, art. 4 (4) and (6).
98 *Ibid.*, art. 5.
99 Council of the European Union, Economic and Financial Affairs Council, 12 March 2019, published online: https://www.consilium.europa.eu/en/meetings/ecofin/2019/03/12/ (last access: 15 January 2022).
100 Council of the European Union, Special meeting of the European Council (17, 18, 19, 20 and 21 July 2020) – Conclusions, 21 July 2020, published online: https://www.consilium.europa.eu/media/45109/210720-euco-final-conclusions-en.pdf (last access: 15 January 2022), para. A29.
101 Council of the European Union, Council conclusions on fair and effective taxation in times of recovery, on tax challenges linked to digitalisation and on tax good governance in the EU and beyond, 27 November 2020, published online: https://data.consilium.europa.eu/doc/document/ST-13350-2020-INIT/en/pdf (last access: 15 January 2022), para. 8.

also emphasised their readiness to adopt an EU-only digital levy should there be no progress.[102] The deadline to implement an EU digital levy has again been set at 1 January 2023.

The European Commission initiated a public consultation procedure from 18 January 2021 to 12 April 2021 on the question of a digital levy.[103] Since then, no more concrete steps can be observed, but the commitment to the OECD global consensus solution seems to be further refreshed in the middle of 2021.[104]

III. "Taxing the digital" in the United Nations Model Tax Convention

Beyond the developments at the level of the OECD and the EU, the United Nations Committee of Experts on International Cooperation in Tax Matters became active and proposed a draft article 12B of the United Nations MC in August 2020. The provision on the taxation of payments for digital services and its related Commentary have been adopted in April 2021.[105] States may include the provision optionally in their DTCs.[106]

Concretely, article 12B envisages the taxation of income defined in its paragraphs 5 and 6 both in the residence and in the source State. Income concerned remunerates "any service provided on the Internet or another electronic network, in either case requiring minimal human involvement from the service provider".[107] Services covered are especially "online advertising services; supply of user data; online search engines; online intermediation platform services; social media platforms; digital content services; online gaming; cloud computing services; and standardized online teaching services".[108]

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[102] Council of the European Union, Informal video conference of economic and finance ministers, 16 March 2021, main results being published online: https://www.consilium.europa.eu/en/meetings/ecofin/2021/03/16/ (last access: 15 January 2022); Council of the European Union, Statement of the Members of the European Council, 25 March 2021, published online: https://www.consilium.europa.eu/media/48976/250321-vtc-euco-statement-en.pdf (last access: 15 January 2022), para. 6 (g).
[103] *See* European Commission, A fair and competitive digital economy – digital levy, published online: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12836-A-fair-competitive-digital-economy-digital-levy/public-consultation_en (last access: 15 January 2022).
[104] European Commission, Taxation: Historic global agreement to ensure fairer taxation of multinational enterprises, 10 July 2021, published online: https://ec.europa.eu/commission/presscorner/detail/%5Beuropa_tokens:europa_interface_language%5D/ip_21_3582 (last access: 15 January 2022): "Once there is a consensus-based global agreement on both Pillars, the Commission will move swiftly to propose measures for their implementation in the EU, in line with the EU's tax agenda and the needs of the Single Market".
[105] *See* UN, "Tax Treatment of Payments for Digital Services", published online: https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-08/TAX%20TREATY%20PROVISION%20ON%20PAYMENTS%20FOR%20DIGITAL%20SERVICES.pdf (last access: 15 January 2022).
[106] J. Martin, "UN committee proposes new model treaty provision altering taxation of automated digital services", *MNE Tax*, 6 August 2020, published online: https://mnetax.com/un-committee-proposes-new-model-treaty-provision-altering-taxation-of-automated-digital-services-39609 (last access: 15 January 2022).
[107] Art. 12B (5) UN MC.
[108] Art. 12B (6) UN MC.

Article 12B (1) to (3) of the UN MC provides for taxation in the residence and source States, with a limited source State taxation at a rate to be negotiated by the tax treaty signatories. Where the recipient of the income is the beneficial owner of such income, article 12B (3) of the UN MC provides for that the taxpayer may opt for net basis taxation according to the tax laws of the source State. The qualified profits for such taxation shall be "thirty percent of the amount resulting from applying the profitability ratio of that beneficial owner's automated digital services business segment to the gross annual revenue from automated digital services derived from the Contracting State where such income arises".[109] As a default rule, where the taxpayer does not maintain segmental accounts, the "overall profitability ratio of the beneficial owner will be applied to determine qualified profits".[110]

In practice, the delimitation of the scopes of application of both articles 12A (fees for technical services) and 12B of the UN MC might bring along difficulties.[111]

IV. What the debate means for Luxembourg

Luxembourg has been traditionally hesitant regarding the implementation of digital tax measures. Not only in the discussions at the OECD level, already in 2018, Luxembourg formed part of the group of States being satisfied with the outcomes of the BEPS project – meaning, it was not further seeking for any adaptations of the (international) corporate tax system. Also, at the level of EU negotiations, Luxembourg remained hesitant to push for the adoption of either of the 2018 directive proposals. Its hesitance has been proven also by the fact that unlike other (neighbouring) Member States, the Grand-Duchy did not take the initiative to implement unilaterally domestic digital tax measures. The position is plausible, since the user base locatable in Luxembourg is limited and certainly taxation based on the number of users or consumption of digital services within the territory would not lead to a significant increase in the Grand-Duchy's tax revenues. Globally, this has been an important criticism regarding the adoption of any digital tax measure, as the expected tax outcome and redistribution seems overall limited considering its global dimension.[112]

From today's perspective, Luxembourg avoids political confrontations in respect of digital tax measures – it is a signatory to the latest 2021 documents and

[109] Art. 12B (3) UN MC.
[110] *Ibid.*
[111] A. Báez, "Because not always B comes after A: Critical Reflections on the new Article 12B of the UN Model Tax Convention on Automated Digital Services", *SSRN*, 16 September 2021, published online: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3923508&download=yes (last access: 15 January 2022).
[112] The OECD refers to the sum of 125 billion US Dollar that may be reallocated: OECD, International community strikes a ground-breaking tax deal for the digital age, 8 October 2021, published online: https://www.oecd.org/tax/international-community-strikes-a-ground-breaking-tax-deal-for-the-digital-age.htm (last access: 15 January 2022).

thereby seems to subscribe (or at least not oppose) the current developments.[113] The impact expected by the private sector of the two-pillar solution of the OECD is limited.[114] Companies resident in Luxembourg should not be faced by higher tax burdens in the Grand-Duchy. However, the administrative burden is expected to be high, particularly for the tax authorities of small countries like Luxembourg.[115]

Conclusion

The contribution provides a historic overview of developments on the taxation of the digitalized economy at the international, European and Luxembourg domestic level. It presents the length of negotiations that demonstrate the importance of the topic and the difficulty to find consensus on a topic as political as the redistribution of tax revenues.

In early 2022, no common solution has been adopted yet that would fundamentally reform the existing international tax order. Nevertheless, such change is visible at the horizon. In the meantime, some States have adopted unilateral tax measures, which, however, often are subject to political compromises and remained unapplied in practice.[116]

Luxembourg refrained from adopting any unilateral digital tax measure. In case of adoption of the amount A solution currently discussed at the level of the OECD, it may be expected that the administrative burden of implementing the tax (both on the side of taxpayers as well as the Luxembourg tax authority) will probably not stand in any relation with the tax outcome effectively generated, which does not favour strict enforcement.

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[113] OECD, Members of the OECD/G20 Inclusive Framework on BEPS joining the October 2021 *Statement on a Two-Pillar Solution to address the Tax Challenges Arising from the Digitalisation of the Economy* as of 4 November 2021, published online: https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-members-joining-statement-on-two-pillar-solution-to-address-tax-challenges-arising-from-digitalisation-october-2021.pdf (last access: 15 January 2022); OECD, Members of the OECD/G20 Inclusive Framework on BEPS joining the *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* as of 31 August 2021, published online: https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-members-joining-statement-on-two-pillar-solution-to-address-tax-challenges-arising-from-digitalisation-july-2021.pdf (last access: 15 January 2022).

[114] A. Boob, « Accord OCDE: ce qui va changer au Luxembourg », *Paperjam*, 13 octobre 2021, https://paperjam.lu/article/accord-ocde-ce-qui-va-changer- (last access: 15 January 2022).

[115] *Ibid.*

[116] *See, e.g.,* BDO, France – Digital Services Tax, published online: https://www.bdo.global/en-gb/microsites/digital-services-taxation/countries-cit-map/france-digital-services-tax (last access: 15 January 2022): "The tax was suspended, but since no agreement has been reached at the OECD on the taxation of the digital economy, the Minister of Economy announced that France would apply the Digital services tax as from December 2020"; Office of the United States Trade Representative, "USTR Welcomes Agreement with Austria, France, Italy, Spain, and the United Kingdom on Digital Services Taxes", 21 October 2021, published online: https://ustr.gov/about-us/policy-offices/press-office/press-releases/2021/october/ustr-welcomes-agreement-austria-france-italy-spain-and-united-kingdom-digital-services-taxes (last access: 15 January 2022).